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CULPA IN CONTRAHENDO, BARGAINING IN GOOD FAITH, AND FREEDOM OF CONTRACT: A COMPARATIVE STUDY

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The common law appears to have no counterpart to the German doctrine of culpa in contrahendo: that contracting parties are under a duty, classified as contractual, to deal in good faith with each other during the negotiation stage, or else face liability, customarily to the extent of the wronged party's reliance. In this comparative study Professor Kessler and Mrs. Fine find, however, that notions of good faith and fair dealing are frequently expressed in the American contract law affecting preliminary negotiations, firm offers, mistake, and misrepresentation, and that the doctrines of negligence, estoppel, and implied contract, among others, have at the same time served many of the doctrinal functions of culpa in contrahendo.

I. INTRODUCTION

THE doctrine of *culpa in contrahendo* goes back to a famous article by Jhering, published in 1861, entitled "*Culpa in contrahendo, oder Schadensersatz bei nichtigen oder nicht zur Perfektion gelangten Verträgen.*"¹ It advanced the thesis that damages should be recoverable against the party whose blameworthy conduct during negotiations for a contract brought about its invalidity or prevented its perfection. Its impact has reached beyond the German law of contracts.

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¹ 4 JAHRBÜCHER FÜR DIE DOGMATIK DES HEUTIGEN RÖMISCHEN UND DEUTSCHEN PRIVATRECHTS 1 (1861), reprinted in 1 VON JHERING, GESAMMELTE AUFSÄTZE 327 (1881). For discussion of Jhering's article see 1 WILLISTON, CONTRACTS § 63A (rev. ed. 1936); 5 *id.* § 1600B [hereinafter cited as WILLISTON]; Fuller & Perdue, *The Reliance Interest in Contract Damages: 1*, 46 YALE L.J. 52, 86 (1936); Patterson, *Equitable Relief for Unilateral Mistake*, 28 COLUM. L. REV. 859, 886 (1928).

In Jhering's view, the German common law of his day, the so-called *Gemeines Recht*, was seriously defective in not paying sufficient attention to the needs of commerce. It did not adequately correct the will theory² and the meeting of minds requirement. To give some of his illustrations: a slip of the pen, an erroneous transmission of an offer or acceptance, an essential unilateral mistake as to the identity of the other party or of the subject matter, however impalpable, fatally affected the validity of the contract. As a result a buyer, for instance, who inadvertently ordered 100 pounds instead of the intended ten was not liable to reimburse the seller for the costs of transporting the merchandise rejected. Furthermore, he argued, the prevailing view made it impossible for an offeree to rely on the perfection of the contract even if he had dispatched his acceptance because death of the offeror might have occurred or revocation of the offer might have been sent before the acceptance had become effective. Objective impossibility, finally, even if known to the promisor, brought about the invalidity of the contract. These and other instances where a party by "lack of diligence" had prevented the consummation of a valid contract persuaded Jhering to raise in a systematic fashion the question whether the "blameworthy" party should not be held liable to the innocent party who had suffered damages relying on the validity of the contract. His answer was in the affirmative. Of course, the party who has relied on the validity of the contract to his injury will not be able to recover the value of the promised performance, the expectation interest. But, he suggested, the law can ill afford to deny the innocent party recovery altogether; it has to provide for the restoration of the *status quo* by giving the injured party his "negative interest" or reliance damages. The careless promisor has only himself to blame when he has created for the other party the false appearance of a binding obligation.³ This is the meaning of *culpa in contrahendo*.⁴

² For the influence of the will theory on German law see Windscheid, *Wille und Willenserklärung*, 63 ARCHIV FÜR DIE CIVILISTISCHE PRAXIS 72 (1880); 1 STAUDINGER, KOMMENTAR ZUM BÜRGERLICHEN GESETZBUCH § 119, Anm. 2, 3 (11th ed. 1957) [hereinafter cited as STAUDINGER]. But see, e.g., Bähr, *Ueber Irrungen im Contrahiren*, 14 JAHRBÜCHER FÜR DIE DOGMATIK DES HEUTIGEN RÖMISCHEN UND DEUTSCHEN PRIVATRECHTS 393 (1875), defending the objective theory of contracts. For the will theory in the common law, see Pound, *The Role of the Will in Law*, 68 HARV. L. REV. 1, 14 (1954); Williston, *Freedom of Contract*, 6 CORNELL L.Q. 365, 367-69 (1921).

³ Jhering, *supra* note 1, at 7, 16-17, 34-35, 42, 44.

⁴ "Fault in negotiating." Committed to the thesis that liability was based on fault, Jhering had to stretch "fault" beyond recognition to save his theory. Thus

Although Jhering's reading of the then existing law, particularly his interpretation of the Roman sources, and the *culpa* rationale he advanced were subjected to criticism,⁵ his basic ideas have strongly influenced the development of many though not all civil law systems. This is particularly true for the German legal system. The framers of the civil code, it is true, were not ready to adopt a general theory of *culpa in contrahendo*. But in some of the code's provisions the impact of Jhering's theories can be clearly seen. For instance, the civil code drastically modified the will theory of contracts so as to protect injurious reliance. While a promise made in the belief that it will not be taken seriously is still void, and a promise affected by unilateral mistake may still be voidable, the party injured by invalidity or disaffirmance of a contract will be entitled to recover his reliance interest. Going beyond Jhering, liability in these situations does not even presuppose fault.⁶ Thus the civil code, although not adopting the objective theory, has broken with the will theory in its radical form and adopted a compromise solution aiming at the protection of both parties. Furthermore, under section 307, the code has adopted the Jhering solution of the impossibility problem, providing that one who knows or ought to know of an existing impossibility is liable in damages to the extent of the other party's reliance.

In the decades following the enactment of the civil code, case law with the aid of the legal literature began to treat the isolated provisions of the code as instances of a general scheme of pre-contractual liability.⁷ Going beyond a mere correction of the will

if the offeror's death had made a mailed acceptance ineffective, he was deemed at fault for having used the "unsafe" method of correspondence rather than the "safe" way of contracting by parol. *Id.* at 93-94. The reasons for Jhering's technique are admirably set out in BROCK, *DAS NEGATIVE VERTRAGSINTERESSE* 48-56 (1902). For criticism see 1 DEMOGUE, *TRAITÉ DES OBLIGATIONS EN GÉNÉRAL* 95 (1923).

⁵ See 1 FOERSTER-ECCIUS, *PREUSSISCHES PRIVATRECHT* 455-58 (7th ed. 1896); MOMMSEN, *UEBER DIE HAFTUNG DER CONTRAHENTEN BEI DER ABSCHLIESSUNG VON SCHULDVERTRÄGEN* 5-12 (1879). Windscheid, although rejecting Jhering's *culpa* rationale, favored the imposition of liability — anchored in notions of good faith — in most of the situations enumerated by Jhering. See 2 WINDSCHEID, *LEHRBUCH DES PANDEKTENRECHTS* § 307 n.5. (8th ed. 1900).

⁶ *BÜRGERLICHES GESETZBUCH* [hereinafter cited as B.G.B.] §§ 116, 119, 122, 179, para. 2, 307, 309.

⁷ The provisions of the civil code often referred to are: B.G.B. §§ 122, 149, 179, 307, 309, 463, 523, para. 1, 524, para. 1, 600, 663, 694; *HANDELSGESETZBUCH* [hereinafter cited as H.G.B.] § 362. Categorization of *culpa in contrahendo* situations was attempted in Oct. 29, 1938, 159 *Entscheidungen des Reichsgerichts in*

dogma, *culpa in contrahendo* became anchored in the great principle of good faith and fair dealing which permeates, we are told, the whole law of contracts, controlling, indeed, all legal transactions.⁸ The comprehensive theory which has gradually emerged is still in the process of expansion.⁹ Once parties enter into negotiations for a contract, the sweeping language of the cases informs us, a relationship of trust and confidence comes into existence, irrespective of whether they succeed or fail.¹⁰ Thus, protection is accorded against blameworthy conduct which prevents the consummation of a contract. A party is liable for negligently creating the expectation that a contract would be forthcoming although he knows or should know that the expectation cannot be realized.¹¹ Furthermore, the parties are bound to take such precautionary measures as are necessary for the protection of each other's person or property. A store, for instance, is liable in accordance with contract principles to a customer who is injured through the negligent handling of merchandise by a clerk. So is the owner of a restaurant to a guest who enters and is injured because the premises are unsafe.¹²

Of particular importance are the duties of disclosure imposed on negotiating parties in the interest of fair dealing and the security of transactions. Each party is bound to disclose such

Zivilsachen [hereinafter cited as R.G.Z.] 31, 54-55. See generally 3 LARENZ, LEHRBUCH DES SCHULDRECHTS § 4 V, at 38-43 (5th ed. 1962) [hereinafter cited as LARENZ, LEHRBUCH]; LEHMANN, ALLGEMEINER TEIL DES BÜRGERLICHEN GESETZBUCHES 222-24 (12th ed. 1960); Larenz, *Culpa in Contrahendo, Verkehrssicherungspflicht und "sozialer Kontakt,"* 8 MONTSSCHRIFT FÜR DEUTSCHES RECHT 515 (1954); Nirk, *Rechtsvergleichendes zur Haftung für Culpa in Contrahendo*, 18 RABEL'S ZEITSCHRIFT 310 (1953).

⁸ 1 LARENZ, LEHRBUCH 39, 100-15. The *Reichsgericht* has constantly emphasized good faith and security of transactions. See, e.g., April 5, 1922, 104 R.G.Z. 265; Sept. 24, 1918, 95 R.G.Z. 58.

⁹ 1 RABEL, DAS RECHT DES WARENKAUFS 157-59 (1936), warns against applying the doctrine too broadly. See also Titze, *Verschulden beim Vertragsschluss*, 6 HANDWÖRTERBUCH DES RECHTSWISSENSCHAFT 516 (Stier-Somlo & Elster eds. 1929).

¹⁰ See June 20, 1952, 6 Entscheidungen des Bundesgerichtshofes in Zivilsachen [hereinafter cited as B.G.H.Z.] 330-33; Oct. 29, 1938, 159 R.G.Z. 33, 54-55; June 22, 1936, 151 R.G.Z. 357, 358-60; March 11, 1932, 135 R.G.Z. 339, 346-47; March 1, 1928, 120 R.G.Z. 249, 251; Nov. 28, 1923, 107 R.G.Z. 357, 360-63; April 5, 1922, 104 R.G.Z. 265; Sept. 24, 1918, 95 R.G.Z. 58, 60-61.

Culpa in contrahendo covers the phase of negotiation as well as the phase of consummation. The *Reichsgericht* has tended to impose duties of *culpa in contrahendo* as early as possible to overcome the shortcomings of German tort law. Certainly an offer is not required. See May 5, 1911, 76 R.G.Z. 239.

¹¹ Jan. 19, 1934, 143 R.G.Z. 219.

¹² Dec. 7, 1911, 78 R.G.Z. 239; June 14, 1910, 74 R.G.Z. 124.

matters as are clearly of importance for the other party's decision, provided the latter is unable to procure the information himself and the nondisclosing party is aware of the fact.¹³ To illustrate: The owner of a house negotiating for its sale has made arrangements for inspection with a prospective buyer. He fails to give notice that he has sold the house to a third party and the prospective buyer makes a trip in vain.¹⁴ The seller of a house "negligently" fails to notify the buyer that the housing authority is planning to take over the rental of the house making it impossible for the buyer to move in. The action of the housing authority frustrates the purpose of the contract envisaged by the buyer and known to the seller.¹⁵ A party "negligently" discharging his duty to inform by giving erroneous information is equally liable.¹⁶ In all these instances *culpa in contrahendo* has been invoked and the blameworthy party held liable for the resulting injury. The victim is to be restored to the position he would have occupied had there been no violation of the duty of disclosure. Since in most situations where the duty to disclose was violated the other party, if correctly informed, would have abstained from entering into the contract, it makes good sense to measure liability, as a rule, on the basis of the reliance interest and not in terms of the benefit anticipated, the expectation interest. For example, one who enters into a partnership agreement on the basis of misleading information concerning the value of assets to be brought into the venture by the other party is entitled to be put in the position he would be in had he received correct information. Since, in all likelihood, he would not have joined a partnership on the basis of correct information, he is entitled to recover the loss he suffers if the partnership fails due to undercapitalization.¹⁷ But he is not entitled to recover his expected profits. The expectation interest can only be recovered if it can be shown that without *culpa in contrahendo* the contract would have been concluded on the terms anticipated by the innocent party.¹⁸

¹³ April 26, 1912, Reichsgericht, 41 Juristische Wochenschrift [hereinafter cited as J.W.] 743; see BLOMEYER, ALLGEMEINES SCHULDRECHT 79 (2d ed. 1957).

¹⁴ The illustration is taken from 1 LARENZ, LEHRBUCH 39.

¹⁵ See Oct. 5, 1931, Reichsgericht, 25 Leipziger Zeitschrift für Deutsches Recht 1377; April 26, 1912, Reichsgericht, 41 J.W. 743 (licensor failed to notify licensee of infringement claim by competitor).

¹⁶ Sept. 24, 1918, 95 R.G.Z. 58 (additional expenses recovered despite fixed price contract).

¹⁷ The illustration is taken from 1 LARENZ, LEHRBUCH 42.

¹⁸ LEHMANN, *op. cit. supra* note 7, at 223. For discussion of the measure of

Liability for *culpa in contrahendo*, in keeping with the generally applicable principle governing contractual liability under German law, presupposes fault, *i.e.*, at least negligence.¹⁹ Since the standards of negligence are objective it is sufficient that the party to be held liable deviated from the standards of care and fairness expected under the circumstances.²⁰ Nevertheless, the classification of *culpa in contrahendo* liability as contractual, which is constantly emphasized, is of great practical importance due to the inadequacy of tort law. German tort law, in contrast to other civil law systems, has not adopted a general principle of liability wherever there is injury caused by fault. Instead it consists of a number of individual torts, and negligent causing of mere pecuniary harm, as distinct from injury to the person or property, is not one of them. Furthermore, while a contracting party is equally liable on the contract whether he acts personally or through an agent, in tort a principal is liable for the acts of his agent only if he is guilty of negligent selection or supervision.²¹

The impact of Jhering's thesis has not been confined to the German law of contracts. *Culpa in contrahendo* doctrine has profoundly affected Austrian and Swiss law.²² It has been widely discussed in the French literature and may thus have influenced the case law, even if only indirectly.²³ However, in contrast to developments in Germany, precontractual duties of care seem to have become an issue mainly in situations where strict adherence to classical will theory and to the meeting of minds requirement

damages, see June 22, 1936, 151 R.G.Z. 357, 359-61. The measure of damages for fraudulent concealment of defects of movables is the expectation interest. B.G.B. § 463.

¹⁹ B.G.B. § 276; Sept. 24, 1918, 95 R.G.Z. 58.

²⁰ 1 LARENZ, *LEHRBUCH* § 19 III, at 205-09.

²¹ B.G.B. §§ 823, 278, 831; Sept. 24, 1918, 95 R.G.Z. 58, 60; VON CAEMMERER, *WANDLUNGEN DES DELIKTSRECHTS* 56 (1960).

²² Austrian law: 4 KLANG, *KOMMENTAR ZUM ALLEGEMEINEN BÜRGERLICHEN GESETZBUCH* § 878 (2d ed. 1951). Swiss law: Barben v. Moser, *Cour de Justice Civile*, April 18, 1952, 75 *Semaine Judiciaire* 193; Meyer v. Ville de Neuchâtel, *Cour Civile*, June 6, 1951, 77(II) *Entscheidungen des Schweizerischen Bundesgerichtes* [hereinafter cited as S.B.G.] 135; Roller v. Lüscher, *Bundesgericht*, Nov. 8, 1932, 58(II) S.B.G. 429; 1 VON TUHR-SIEGWART, *ALLGEMEINER TEIL DIES SCHWEIZERISCHEN OBLIGATIONENRECHTS* 183-84 (2d ed. 1942); Rabel, *Der sogen. Vertrauensschaden im schweizerischen Recht*, 27 *ZEITSCHRIFT FÜR SCHWEIZERISCHES RECHT (NEUE FOLGE)* 291 (1908).

²³ See 2 COLIN & CAPITANT, *TRAITÉ DE DROIT CIVIL* at No. 626 (Léon Juillot de la Morandière ed. 1959) [hereinafter cited as COLIN & CAPITANT]; 1 H. MAZEAUD, L. MAZEAUD & TUNC, *TRAITÉ THÉORIQUE ET PRATIQUE DE LA RESPONSABILITÉ CIVILE* at Nos. 116, 121 (5th ed. 1957); COHÉRIER, *DES OBLIGATIONS NAISSANT DES POURPARLERS PRÉALABLES À LA FORMATION DES CONTRATS* 60-79 (1939).

was found to lead to undesirable results. The elaborate and detailed expansion of precontractual duties, characteristic of German law, appears to have no French counterpart. The *Code Civil* itself, however, furnishes an illustration of the *culpa in contrahendo* principle, providing in article 1599 that while the sale of a thing belonging to another is void, if the purchaser is unaware of the seller's defective title he may recover damages from him. Since French, unlike German tort law, recognizes a general liability for fault,²⁴ the widespread discussion of Jhering's theory is noteworthy. Jhering's influence on the development of the Italian law is more pronounced. The new Italian code of 1942 has introduced two provisions codifying the doctrine. Article 1337 contains an express provision imposing a *responsabilità precontrattuale* in accordance with the principles of good faith, and article 1338 prescribes that a party who, when entering into the contract, knew or should have known of its invalidity must reimburse the other party who innocently relied on its validity.

To sum up: whatever their theoretical basis or range of application, notions of good faith in the form of *culpa in contrahendo* or otherwise have become firmly established in the civil law system. Thus, the idea that parties when negotiating for a contract are dealing at arm's length has found a powerful rival. Indeed, it has been claimed, particularly in the German literature, that the expansion of Jhering's doctrine is one of the many striking instances illustrating increasing awareness of the social nature of the institution of contract and the profound transformation of its law. The success of the doctrine, it has been asserted, is a clear indication of the inadequacy of the model employed or presupposed in classical theory of contracts and its great civil law codifications.²⁵ This is a challenging thesis indeed, and all the more since it creates the impression of a profound cleavage between the philosophies of contract underlying the civil and the common law. The common law of contracts, its case law informs us, permits negotiating parties to deal with one another at arm's length. To be

²⁴ See CODE CIVIL arts. 1382-84.

²⁵ See HAUPT, UEBER FAKTISCHE VERTRAGSVERHÄLTNISSE 9 (1941); SIMITIS, DIE FAKTISCHEN VERTRAGSVERHÄLTNISSE ALS AUSDRUCK DER GEWANDELTEN SOZIALEN FUNKTION DER RECHTSINSTITUTE DES PRIVATRECHTS 587-90 (1957); Wieacker, *Willenserklärung und Social-Typisches Verhalten*, in GÖTTINGER FESTSCHRIFT FÜR DAS OBERLANDESGERICHT CELLE 95 (1961). Modern French literature emphasizes the socialization of contract law. See, e.g., Josserand, *Aperçu Général des Tendances actuelles de la Théorie des Contrats*, 36 REVUE TRIMESTRIELLE DE DROIT CIVIL 1, 29 (1937).

sure, since the days when Lord Mansfield began to shape the modern law of contracts, it has come to recognize the duty to perform in good faith.²⁶ Indeed, the Uniform Commercial Code has now imposed an obligation to perform in good faith, and defines good faith in terms of "honesty in fact" and, "in the case of a merchant, observance of reasonable commercial standards of fair dealing in the trade."²⁷ But, it is argued, the good faith principle ought not to be carried over into the formation stage of contracts.²⁸ While American labor law does go so far as to expressly impose the duty to bargain in good faith, the Taft-Hartley Act is quite explicit in preserving freedom of contract. It expressly states that the "obligation [to bargain in good faith] does not compel either party to agree to a proposal or require the making of a concession."²⁹ Discussions of the general law of contracts have ignored this by no means generally approved expansion and have limited such duty to cases where a fiduciary relationship exists.³⁰

Our paper is an attempt to study *culpa in contrahendo* and the requirement of good faith on a comparative basis so as to determine whether these notions are completely foreign to the way of thinking of a common law lawyer. Given the similarity in the structure of Western commercial and industrial society this is hardly plausible, despite the powerful influence of tradition. The absence of good faith language is by no means conclusive. Notions of *culpa in contrahendo* and good faith have clearly given rise to many concepts applicable during the negotiation stage, such as the notions of promissory estoppel and the implied in fact collateral contract, which have been employed in order to protect reasonable reliance on a promise.³¹ Furthermore, the German contract rules of good faith find their functional equivalent in certain common law tort doctrines, such as the special liability of a proprietor to a business invitee. To study the impact of the

²⁶ *Kirke La Shelle Co., v. Paul Armstrong Co.*, 263 N.Y. 79, 87, 188 N.E. 163, 167 (1933); *Boone v. Eyre*, 1 H. Bl. 273, 126 Eng. Rep. 160(a) (K.B. 1777); *Kingston v. Preston*, 2 Doug. 689, 99 Eng. Rep. 437 (K.B. 1773).

²⁷ UNIFORM COMMERCIAL CODE §§ 1-203, 201(19), 2-103(1)(b).

²⁸ See, e.g., *United States v. Braunstein*, 75 F. Supp. 137 (S.D.N.Y. 1947), *appeal dismissed*, 168 F.2d 749 (2d Cir. 1948).

²⁹ Labor-Management Relations Act § 8(d), 61 Stat. 142 (1947), 29 U.S.C. § 158(d) (1958). For the meaning of the term see *NLRB v. Insurance Agents' Int'l Union*, 361 U.S. 477 (1960); Cox, *The Duty to Bargain in Good Faith*, 71 HARV. L. REV. 1401 (1958).

³⁰ See *Woodmont, Inc. v. Daniels*, 274 F.2d 132, 137-38 (10th Cir. 1959).

³¹ See, e.g., *Drennan v. Star Paving Co.*, 51 Cal. 2d 409, 333 P.2d 757 (1958).

ideas of good faith on the law dealing with contract in the negotiation stage it seems best to start with the cardinal notion of the classical theory: freedom of contract. This is necessary since the good faith principle so applied will, we are told, conflict with this great idea.

II. FREEDOM OF CONTRACT AND GOOD FAITH

A. *Compulsory Contracts*

Classical contract theory, both in civil law and common law countries, has found its most striking expression in the idea of freedom of contract, the counterpart, if not the result, of free enterprise capitalism. Contract liability, in principle, presupposes an agreement or at least a promise voluntarily given. There is no duty to contract except on terms agreed upon. Contract and compulsion, in this view, are antithetical notions.³² Freedom of contract has its corollary in the "policy of certainty" and the principle of judicial nonintervention. The terms of an agreement to be enforceable should be "so certain that parties can know what to rely upon and courts can determine when performance or breach has occurred and what the precise remedy should be." Furthermore, the responsibility for making an enforceable contract has to rest with the parties, and courts should have no power to alter agreements or construe parties into contracts.³³

And yet in an expanding area not limited to the countries of the civil law system, society has come to rely on a duty to contract or on compulsory contracts to insure the supply of certain necessities of individual and commercial life. Often at least one of the parties may be entering into an agreement because he is under an enforceable duty to do so, or the terms of a contract may wholly or in part have been prescribed by statutory fiat.³⁴ Public utilities

³² Among leading commentators, see Oftinger, *Die Vertragsfreiheit*, in *DIE FREIHEIT DES BÜRGERS IM SCHWEIZERISCHEN RECHT* 315 (1948) (Swiss law); Raïser, *Vertragsfreiheit Heute*, 13 *JURISTENZEITUNG* 1 (1958) (German law); 6(1) *PLANIOL & RIPERT, TRAITÉ PRATIQUE DE DROIT CIVIL FRANÇAIS* 19-49 (2d ed. 1952) [hereinafter cited as *PLANIOL & RIPERT*] (French law); *FRIEDMANN, LAW IN A CHANGING SOCIETY* 92-94 (1959) (British law); Patterson, *Compulsory Contracts in the Crystal Ball*, 43 *COLUM. L. REV.* 731 (1943) (American law).

³³ See PATTERSON, *ANALYSIS OF UNIFORM COMMERCIAL CODE* § 2-204, at 274 (N.Y.L. Revision Comm'n Leg. Doc. No. 65(C), 1955).

³⁴ See Grunfeld, *Reform in the Law of Contract*, 24 *MODERN L. REV.* 62 n.2 (1961). As to classification of compulsory contracts, Patterson, *supra* note 32, at 743, has pointed out that "Anglo-American law, with its consensual-relational duties, its feudal survivals and its original tort theory of contract, can stretch its

have been subject to a duty to contract, *i.e.*, a duty to accommodate from available production "without discrimination and on proper terms all who request . . . service."³⁵ Outside the public utilities field the domain of compulsory contracts has been haltingly expanded to areas where protection against the dangers inherent in the conditions of modern life has become a matter of paramount public policy. In this country, for instance, the duty to insure against motor and industrial accidents and the corresponding duty imposed upon insurance carriers to accept applications is on the increase.³⁶ In such other fields as fire and life insurance there is no duty to contract, but once the insurance company has accepted an application the terms of the contract are either totally or partially set by statute. It has even been suggested that in the light of the public nature of the insurance company, "it would not . . . be a very long step to the rule that the insurance company must give its service to all proper applicants."³⁷

In recent years the question has been widely debated whether outside the public utility field the duty to contract should be used as a weapon to combat monopolies. This discussion has not been confined to the United States. In Germany, for instance, the former *Reichsgericht*, in a long series of decisions, has taken the position that a refusal to deal will be actionable if it has as its purpose unfair competition or the exploitation of a monopoly and is

conception of consensual obligation pretty far." See, *e.g.*, *Upton-on-Severn Rural Dist. Council v. Powell*, [1942] 1 All E.R. 220 (C.A.).

Due to the strong emphasis on contractual intent, the German law had even greater difficulty and developed a new category of implied-in-fact contract, calling it "*Faktisches Vertragsverhältnis*." See July 14, 1956, 21 B.G.H.Z. 319, 333. This category is not foreign to the American lawyer's thinking. See Costigan, *Implied-in-Fact Contracts and Mutual Assent*, 33 HARV. L. REV. 376, 383 (1920).

³⁵ RESTATEMENT, TORTS § 763 (1939). For economic discussion, see BAIN, INDUSTRIAL ORGANIZATION 542 (1959). See Raiser, *Der Gleichheitsgrundsatz im Privatrecht*, 111 ZEITSCHRIFT FÜR DAS GESAMTE HANDELSRECHT UND KONKURSRECHT 75, 86 (1948) (German law); Morel, *Le Contrat Imposé*, in 2 LE DROIT PRIVÉ FRANÇAIS AU MILIEU DU VINGTIÈME SIÈCLE, ETUDES OFFERTES À GEORGES RIPERT 116-26 (1950).

³⁶ In some jurisdictions the "duty to insure" is only indirectly enforced by suspension of license or, if a foreign corporation, by restraining it from doing business. See Lenhoff, *The Scope of Compulsory Contracts Proper*, 43 COLUM. L. REV. 586, 595 n.50 (1943). In other jurisdictions mandamus or injunction is available. See, *e.g.*, *Texas Employers' Ins. Ass'n v. United States Torpedo Co.*, 26 S.W.2d 1057 (Tex. Comm'n App. 1930); *cf.* *Andrews v. Chesapeake & Potomac Tel. Co.*, 83 F. Supp. 966 (D.D.C. 1949) (injunction possible against discontinuance of telephone service).

³⁷ Patterson, *The Delivery of a Life-Insurance Policy*, 33 HARV. L. REV. 198, 216-17 (1919).

aimed either at the elimination of a potential competitor or the extortion of unfair terms.³⁸ In this country the privilege of a "private trader" to deal with whom he pleases, the so-called *Colgate* doctrine,³⁹ has been considerably modified. Refusals to deal by a single seller, irrespective of his market position, have not been proscribed. Rather, the modification has taken the form of expanding what may be termed "joint action." Even here the protection accorded to the injured party is still imperfect under present antitrust laws.⁴⁰

In France, during the last two decades, the reaction against freedom of contract has been most dramatic. To curb its abuses in the form of restrictive and discriminatory practices, French legislation has subordinated freedom of contract to what is believed to be freedom of competition. Pricing practices, such as resale price maintenance, the continued imposition of discriminatory conditions of sale, price discrimination not justified by cost, and tie-ins have been made criminal offenses. So have refusals to deal (*refus de vente*): Any producer, trader, person engaged in industry, or craftsman is under duty to "satisfy to the best of his ability and upon the customary trade terms any request for the purchase of goods or the performance of services which has no abnormal character and is made in good faith" ⁴¹ Thus the refusal to deal provision reaches a broader group than the statutory duty to deal imposed in this country by the original Clayton Bill passed by the House in 1914.⁴² Its provision, subsequently excised by the Senate, imposed a duty upon owners and trans-

³⁸ See 1 LARENZ, *LEHRBUCH* § 5.

³⁹ *United States v. Colgate & Co.*, 250 U.S. 300 (1919). Erosion of the doctrine is discussed in Levi, *The Parke, Davis-Colgate Doctrine: the Ban on Resale Price Maintenance*, *SUPREME COURT REVIEW* 258 (1960); Turner, *The Definition of Agreement Under the Sherman Act: Conscious Parallelism and Refusals to Deal*, 75 *HARV. L. REV.* 655, 684-95 (1962).

⁴⁰ See *Nelson Radio & Supply Co. v. Motorola, Inc.*, 200 F.2d 911 (5th Cir. 1952), *cert. denied*, 345 U.S. 925 (1953); Kessler & Stern, *Competition, Contract, and Vertical Integration*, 69 *YALE L.J.* 1, 83-91, 115-116 (1959); Stern, *A Proposed Uniform State Anti-Trust Law: Text and Commentary on a Draft Statute*, 39 *TEXAS L. REV.* 717, 731 n.51, 747-51 (1961).

⁴¹ Price Ordinance No. 45-1483 of June 30, 1945, [1945] *Sirey Lois Ann.* 1898, as amended by Decree No. 58-545 of June 24, 1958, [1958] *Dalloz Bull. Leg.* 447. For an English translation of extracts, see 1 OECD, *GUIDE TO LEGISLATION ON RESTRICTIVE BUSINESS PRACTICES, EUROPE AND NORTH AMERICA* § 1.0 (1960). For a discussion of French law, see CASEL, *REFUS DE VENTE* (1960); Goldstein, *Administrative Shaping of French Refusal to Deal Legislation*, 11 *AM. J. COMP. L.* 515 (1962); Riesenfeld, *The Legal Protection of Competition in France*, 48 *CALIF. L. REV.* 574 (1960).

⁴² H.R. 15657, 63d Cong., 2d Sess. § 3 (1914).

porters of hydroelectric energy, coal, oil, gas, and other minerals to sell to all responsible persons. Although exclusive dealing contracts in France are not included in the list of prohibited practices, administrative rulings have applied the spirit of the law to these arrangements to make sure that the duty to deal cannot be easily avoided by pleading exclusive dealing contracts which exhaust the supply. Broadly speaking, exclusive dealing contracts are legal in France only if (1) they do not constitute an attempt to evade the statute, (2) the products involved are of high quality or technical complexity which need servicing or demonstration by skilled personnel, and (3) the arrangement calls for exclusivity on both sides. This flexible attitude of the administrative agencies was approved by the *Cour de Cassation*.⁴³ The enforcement of the scheme is left with the Ministry of Finance and Economic Affairs which has discretionary powers with regard to bringing criminal proceedings. There seems to be a tendency to secure compliance with the law without legal proceedings.

B. Preliminary Negotiations and Good Faith

Occasionally, the thesis has been advanced that once parties have entered into negotiations for a contract neither party can break them off "arbitrarily" without compensating the other party for his reliance damages.⁴⁴ Case law and literature, on the whole, however, have had the good sense to reject this idea. If the utility of contract as an instrument of self-government is not to be seriously weakened, parties must be free to break off preliminary negotiations without being held to an accounting.

But this privilege presupposes that the parties have not come to a binding agreement. What may still seem to be a phase of preliminary negotiations to one of the parties may be regarded by the law as a binding commitment in the interest of fair dealing. The further negotiations have progressed the more unsafe it becomes to withdraw.⁴⁵ Modern contract law has gone far in reconciling freedom of contract and the "policy of certainty" of transactions with the dictates of good faith and business convenience. The

⁴³ *Nicolas Soc. Brandt v. Soc. Photo Radio Club*, *Cour de Cassation* (Ch. Crim.), July 11, 1962, [1962] *Recueil Dalloz* 497.

⁴⁴ Saleilles, *De la responsabilité précontractuelle*, 6 *REVUE TRIMESTRIELLE DE DROIT CIVIL* 697 (1907).

⁴⁵ See *Holt v. Swenson*, 252 Minn. 510, 90 N.W.2d 724 (1958). For a borderline case, see *Borg-Warner Corp. v. Anchor Co.*, 16 Ill. 2d 234, 156 N.E.2d 513 (1958).

principle of certainty, requiring full and final agreement for the consummation of a contract, has been relaxed so as not to disappoint legitimate expectations grounded in the reasonable belief that "a deal is on."

1. *Incompleteness.* — Contract law, anxious not to incur the reproach of being "the destroyer of bargains" has permitted parties to keep their arrangements flexible and has taken into account that "business men often record the most important agreements in crude and summary fashion."⁴⁶ Thus, the fact that terms are omitted or left for further agreement does not necessarily give an out to the party anxious to withdraw.⁴⁷

Upon being satisfied that an agreement was intended or that one party justifiably relied on the deal and the other party ought to have known that he would so rely, a court may be ready to supply missing terms or give concrete meaning to indefinite terms, provided, as judges are fond of saying, objective criteria for establishing the terms are available in the agreement itself, a prior or subsequent course of dealing, or accepted business practices. This tendency is particularly important where the party claiming lack of agreement has invited or encouraged action so that nonenforcement would leave the relying party in a disadvantageous position.⁴⁸ To be sure, the mere fact that the parties thought they had

⁴⁶ *Hillas & Co. v. Arcos, Ltd.*, 147 L.T.R. (n.s.) 503, 514 (H.L. 1932); see *Outlet Embroidery Co. v. Derwent Mills*, 254 N.Y. 179, 183, 172 N.E. 462, 463 (1930); *A. M. Webb & Co. v. Robert P. Miller Co.*, 157 F.2d 865 (3d Cir. 1946).

⁴⁷ The traditional distinction between essential and nonessential terms of a contract should not be overemphasized. The parties may themselves determine which terms are essential, *HOLMES, THE COMMON LAW* 330, 331 (1881), and even essential terms may be supplied in accordance with the intention of the parties to be bound if objective criteria are available for determining the measure of the obligation. 1 CORBIN, *CONTRACTS* § 29 (1950), [hereinafter cited as CORBIN]; 4 R.G.R. KOMMENTAR ZUM HANDELSGESETZBUCH, Vorbem. vor § 373, Anm. 23 (2d ed. 1961) (German law).

Modern contract statutes have many gap-filling provisions, not confined to "minor terms." See, e.g., *UNIFORM COMMERCIAL CODE* § 2-305 (price term). Although to be applicable these provisions require intent of the parties to be bound, it is so easily found as to amount to a fiction serving principles of fair dealing.

Indefiniteness or omission of "minor details" will not impair the contract unless it would be unfair to enforce the remainder. *United States v. City of New York*, 131 F.2d 909 (2d Cir.), cert. denied, 318 U.S. 781 (1942); see 1 WILLISTON § 48 (3d ed. 1957). The civil law is substantially in accord. See *SCHWEIZERISCHES OBLIGATIONENRECHT* art. 2 (Swit.), introducing a presumption of validity once all essential terms are agreed on, and requiring the judge to fill in disputed secondary terms. Even where the opposite presumption exists, B.G.B. § 154 (Ger.), the demands of fair dealing may prevent invocation of invalidity. Jan. 20, 1954, *Bundesgerichtshof*, 8 *MONATSSCHRIFT FÜR DEUTSCHES RECHT* 217 (1954).

⁴⁸ See *Morris v. Ballard*, 16 F.2d 175 (D.C. Ct. App. 1926); *Brant v. Cali-*

a contract is not enough to turn an arrangement utterly lacking in definiteness into a contract. But before courts are ready to strike down a bargain "indefiniteness must reach the point where construction becomes futile."⁴⁹ The degree of certainty required varies with the transaction involved; of particular importance, but not a prerequisite, is the fact that a contract with standard terms was contemplated.⁵⁰ In this country the Uniform Commercial Code has attempted to consolidate the gains toward flexibility and fairness made by progressive case law.⁵¹

2. *Formalities.*— Similarly, an agreement of the parties to reduce their informal understanding to a writing does not necessarily mean that so long as this has not been done either party can back out with impunity. The writing envisaged may according to the intention of the parties as interpreted constitute a mere memorial whose absence will not prevent the formation of a contract. Of course courts will honor the intention of parties who stipulate that a binding agreement shall not be formed until the negotiations are reduced to a formal contract.⁵² Frequently the issue has arisen whether a party can prevent the formation of an enforceable contract by refusing to give the promised memorandum or by refusing to cooperate in the formalization of the agreement required for its enforceability. In this country there seems to be a tendency against protecting the promisee from the Statute of Frauds in such cases even if he can prove that the promisor never intended to keep his promise to comply with the

fornia Dairies, Inc., 4 Cal. 2d 128, 48 P.2d 13 (1935); *Foley v. Classique Coaches, Ltd.*, [1934] 2 K.B. 1.

⁴⁹ *Cohen & Sons, Inc. v. Lurie Woolen Co.*, 232 N.Y. 112, 114, 133 N.E. 370, 371 (1921); 1 CORBIN §§ 29, 95; May 10, 1918, Reichsgericht, 73 Seufferts Archiv 258. Frequently interpretation has helped to overcome indefiniteness: the offer is read, for instance, as giving the offeree an option to specify the missing terms. *E.g.*, *Fairmount Glass Works v. Grunden-Martin Woodenware Co.*, 106 Ky. 659, 51 S.W. 196 (1899). *But see Sun Printing & Publishing Ass'n v. Remington Paper & Power Co.*, 235 N.Y. 338, 139 N.E. 470 (1923). If it is the offeree who refuses to cooperate, some courts hold the agreement unenforceable while others give the offeror the damages he would have been entitled to had the offeree exercised his option on terms most favorable to the offeree (minimum recovery rule). *PATTERSON, op. cit. supra* note 33, at 329-30.

⁵⁰ *See Mantell v. International Plastic Harmonica Corp.*, 141 N.J. Eq. 379, 389, 55 A.2d 250, 256 (Ct. Err. & App. 1947); *Aetna Ins. Co. v. Licking Valley Milling Co.*, 19 F.2d 177 (6th Cir.), *cert. denied*, 275 U.S. 541 (1927).

⁵¹ § 2-204. *See* interpretation in *Pennsylvania Co. v. Wilmington Trust Co.*, 166 A.2d 726 (Del. Ch. 1960), *aff'd*, 172 A.2d 63 (Del. 1961). For criticism see Williston, *The Law of Sales in the Proposed Uniform Commercial Code*, 63 HARV. L. REV. 561, 576 (1950).

⁵² *Mississippi & Dominion S.S. Co. v. Swift*, 86 Me. 248, 29 Atl. 1063 (1894).

statute or not to insist on the required memorandum. To hold otherwise would, according to the prevailing case law, thwart the basic purpose of the statute: "to prevent persons from being enmeshed in and harassed by claimed oral promises made in the course of negotiations not ending in contracts reduced to writing" ⁵³ However this rule is not without a counterrule. The promisee will be protected with the help of the doctrine of estoppel if circumstances show that an inequitable advantage has been taken of him, resulting in unjust enrichment or "unconscionable injury." ⁵⁴ Estoppel becomes all the more important if the promisee's injury has not resulted in a benefit to the promisor, since then a restitutionary remedy is not available. ⁵⁵

German law offers striking parallels. The German Civil Code has formal requisites for socially important transactions so as to provide for evidentiary security and to prevent inconsiderate engagements. ⁵⁶ A contract to transfer rights in land, for instance, requires judicial or notarial authentication. All the terms of the contract, including price, must be set out accurately. Non-observation of the prescribed form, for instance, an inaccurate statement of the purchase price to save taxes or fees, makes the transaction void and the parties, as a rule, are within their rights if they claim invalidity. ⁵⁷ But a constant flow of decisions by the former *Reichsgericht* and now the *Bundesgerichtshof* has done much to soften the strictness of the law by applying principles of good faith dealing. Noncompliance with the formal requisites, for instance, cannot be pleaded by a party who has fraudulently talked the other party out of insisting on compliance or who "negligently" has caused the other party mistakenly to believe that no formality is needed to validate the contract. ⁵⁸ Recent decisions have gone even beyond *culpa in contrahendo* doctrine. Fraud or negligence during negotiations are no longer required to estop invocation of noncompliance with formalities. It is enough that lack of compliance with the formality required is pleaded in

⁵³ *Cohen v. Pullman Co.*, 243 F.2d 725, 729 (5th Cir. 1957). But see *General Corp. v. General Motors Corp.*, 184 F. Supp. 231 (D. Minn. 1960).

⁵⁴ *Goldstein v. McNeil*, 122 Cal. App. 2d 608, 611, 265 P.2d 113, 114 (1954) (unconscionable loss).

⁵⁵ *Boone v. Coe*, 153 Ky. 233, 154 S.W. 900 (1913).

⁵⁶ 2 AUSTIN, LECTURES ON JURISPRUDENCE 907 (5th ed. 1885).

⁵⁷ B.G.B. §§ 313, 125; VON MEHREN, THE CIVIL LAW SYSTEM 628-33 (1957) (collecting and translating cases and statements).

⁵⁸ May 21, 1927, 117 R.G.Z. 121, 124; Nov. 15, 1907, *Reichsgericht*, WARNEYER, JAHRBUCH DER ENTSCHEIDUNGEN at No. 38 (1907-1908).

violation of the "community sense of justice."⁵⁹ This is true, in particular, where the party claiming invalidity has enjoyed the benefits of the transaction and wants to avoid performance of his side of the bargain.⁶⁰ It is worthy of note that here *culpa in contrahendo* operates to cure a formally invalid contract, thus giving the innocent party greater protection than his reliance interest.

3. *Silence*. — Common and civil law are in basic agreement that silence of itself does not constitute assent.⁶¹ This is as it should be so long as we believe in freedom of contract. The great principle would suffer serious impairment if the offeror could compel the offeree to take action lest he be bound by an offer unintentionally or, perhaps, even unwillingly. There is, in theory, therefore, no duty to reject an offer by positive action. But, everywhere, the rule that silence does not constitute assent has been qualified. The emerging counterrule has not been confined to situations where the offeree has appropriated benefits (goods or services) without being justified in assuming a donative intent on the offeror's part. Here it is obviously fair to imply a promise to compensate.⁶² The real challenge to freedom of contract is to be found in the growing recognition of a precontractual duty to speak in situations where no benefit was conveyed. Thus modern commercial law has increasingly imposed on members of the business community a duty to reject incoming orders if, on the basis of custom and usage or a prior course of dealing, the offeror was justified in expecting a reply should the order not be accepted. This is particularly true if the offeree or his salesman has solicited

⁵⁹ Nov. 12, 1936, 153 R.G.Z. 59, 61; see Feb. 18, 1955, 16 B.G.H.Z. 334, 336. The estoppel idea appears in the German law in the expressions *Einrede der Arglist* (*exceptio doli*), *Einrede des Verstoßes gegen Treu und Glauben*, and *venire contra factum proprium*. See Nov. 12, 1936, 153 R.G.Z. 59.

⁶⁰ See Nov. 14, 1923, 107 R.G.Z. 180, 181.

⁶¹ See *Prescott v. Jones*, 69 N.H. 305, 41 Atl. 352 (1898) (common law); 4 KLING, *op. cit. supra* note 22, at 79-81 (Austrian law); May 25, 1870, Cour de Cassation (Ch. civ.), [1870] Dalloz Jurisprudence I. 257; RIEG, *LE RÔLE DE LA VOLONTÉ DANS L'ACTE JURIDIQUE EN DROIT CIVIL FRANÇAIS ET ALLEMAND* at Nos. 39-47 (1961) (French law); 2 ENNECCERUS, *ALLGEMEINER TEIL DES BÜRGERLICHEN RECHTS* § 153 (Nipperdey ed. 1960) [hereinafter cited as ENNECCERUS] (German law); *Picard Frères v. Kofmehl*, May 28, 1904, Bundesgericht, 30(II) S.B.G. 298, 301 (Swiss law). The recent French refusals-to-deal legislation, *supra* note 41, being limited to criminal sanctions, has not rendered French case law on silence obsolete. See Goldstein, *supra* note 41, at 516.

⁶² *Day v. Caton*, 119 Mass. 513, 20 Am. Rep. 347 (1876); Laufer, *Acceptance by Silence: A Critique*, 7 DUKE B.A.J. 87 (1939) (common law); 1 STAUDINGER § 151, Anm. 3 (German law).

the offer.⁶³ Some legal systems have reinforced commercial custom by statute, requiring certain classes of merchants to reject explicitly.⁶⁴ But modern contract law has not stopped at this point. The traditional way of treating a delayed acceptance or one which contains additional or different terms as a mere counteroffer which could be ignored with impunity proved unsatisfactory. Typically, statute and case law in civil law countries, responding to felt business needs and notions of fair dealing, have imposed on the offeror a duty to reject a delayed acceptance.⁶⁵ Under our law the risk of a delay in transmission of an acceptance customarily falls on the offeror, since acceptance is effective on dispatch rather than, as the civil law has it, on receipt, and thus protection of the offeree is less often necessary. When such circumstances have arisen our courts have occasionally provided such protection when the offeror, after receipt of the belated acceptance, remained silent even though he had reason to know that the offeree believed the acceptance was timely.⁶⁶ The commercial law of the civil law countries tends to treat the problem of the "variant" acceptance similarly: merchants who receive a letter of confirmation which does not accurately express the prior understanding have been put under a duty to protest. Inaction will make the new terms binding unless they contain material deviations or are made in bad faith.⁶⁷ Our law, by contrast, has until recently strictly adhered to the rule that offer and acceptance must match before we have a contract.⁶⁸ Here the Uniform Commercial Code, guided by notions of good faith, has made an innovation which brings our law closer to the civil law. In dealings between merchants, the terms of a timely "variant" accept-

⁶³ See *Ammons v. Wilson & Co.*, 176 Miss. 645, 170 So. 227 (1936); *Hendrickson v. International Harvester Co.*, 100 Vt. 161, 135 Atl. 702 (1927).

⁶⁴ *E.g.*, H.G.B. § 362 (Ger.) (mercantile trader).

⁶⁵ See B.G.B. § 149 (Ger.); ALLGEMEINE BÜRGERLICHE GESETZBUCH § 862a (Aust.); 6(1) *PLANIOL & RIPERT* at No. 138 (French law).

⁶⁶ *Phillips v. Moor*, 71 Me. 78 (1880). See generally 1 *CORBIN* § 74 (1950). Furthermore, timely acceptance of an option cannot be defeated by making the recipient unable to communicate his acceptance in violation of principles of fair dealing. *Unatin 7-Up Co. v. Solomon*, 350 Pa. 632, 39 A.2d 835 (1944).

⁶⁷ July 5, 1930, 129 R.G.Z. 347; Feb. 25, 1919, 95 R.G.Z. 48 (German law). French law has come close, if it has not reached the same position. 6(1) *PLANIOL & RIPERT* at No. 109.

⁶⁸ See *Poel v. Brunswick-Balke-Collender Co.*, 216 N.Y. 310, 110 N.E. 619 (1915), criticized in *FULLER, BASIC CONTRACT LAW* 178-80 (1947). New York cases are collected in *Patterson, supra* note 33, at 295-98. To protect reasonable expectations courts have, however, occasionally disregarded the variant acceptance. See, *e.g.*, *Shane Bros. & Wilson Co. v. Striglos*, 228 Ill. App. 397 (1923).

ance or of a letter of confirmation will become part of and consummate the contract if not objected to, so long as the changes are not material, and the offer did not expressly limit acceptance to the original terms.⁶⁹

Should contract law venture beyond these fairly well recognized classes of cases? Should it, on general principles, impose a duty to speak whenever notions of good faith and fair dealing so demand? Not all legal systems answer in the affirmative. French law, for instance, has been rather reluctant to invoke notions of good faith on a broad scale. Still, the triers of fact, we are told, have considerable leeway in evaluating the circumstances of an individual case.⁷⁰ German law, by contrast, has gone far in its break with tradition. Notions of good faith and *culpa in contrahendo* have become powerful instruments in the hands of courts willing to protect what they regard as reasonable expectations created by inaction. And the application of these principles has not been confined to transactions between merchants.⁷¹ In our own case law there is striking language expressing a good faith philosophy: "When a party is under a duty to speak, or when his failure to speak is inconsistent with honest dealings and misleads another, then his silence may be deemed to be acquiescence."⁷² But it would be rash to regard this statement as a reliable guide through the labyrinth of our law on silence. To be sure, the statement has been used in situations when it was or should have been clear to one of the parties how his conduct during negotiations was understood by the other party and yet he did nothing to correct the impression.⁷³ But in the light of other cases denying protec-

⁶⁹ UNIFORM COMMERCIAL CODE § 2-207. For a tortured interpretation of the section to arrive at a defensible result, see *Roto-Lith, Ltd. v. F. P. Bartlett & Co.*, 297 F.2d 497 (1st Cir. 1962), penetratingly criticized in Davenport, *How To Handle Sales of Goods*, Bus. Law., Nov. 1963, pp. 75-89. For a vigorous defense of the section, see LLEWELLYN, MEMORANDUM REPLYING TO THE REPORT AND MEMORANDUM OF TASK GROUP 1, at 55-57 (N.Y.L. Revision Comm'n, Leg. Doc. No. 65(B)) (1954).

⁷⁰ Rieg, *op. cit. supra* note 61, Nos. 34-42.

⁷¹ See 1 STAUDINGER § 116, Vorbem. 6a.

⁷² *More v. New York Bowery Fire Ins. Co.*, 130 N.Y. 537, 545, 29 N.E. 757, 759 (1892). One accepting an offer for a unilateral contract has a duty to notify the offeror, who may be otherwise unable to know of the acceptance. *Bishop v. Eaton*, 161 Mass. 496, 37 N.E. 665 (1894); RESTATEMENT, CONTRACTS § 56 (1932). For the offeror's predicament without requirement of notice see *Crook v. Cowan*, 64 N.C. 743 (1870).

⁷³ See, e.g., *Church v. Bobbs-Merrill Co.*, 170 F. Supp. 32 (S.D. Ind.), *aff'd*, 272 F.2d 212 (7th Cir. 1959); *Strauss Bros. v. Denton*, 140 Miss. 745, 106 So. 257 (1925); *National Union Fire Ins. Co. v. Ehrlich*, 122 Misc. 682, 203 N.Y. Supp. 434 (App. T. 1924) (renewal of fire policy).

tion we may be justified in saying that the statement has more often been honored in the breach.⁷⁴ The traditional notion that parties when negotiating for a contract should look out for their own protection is still exercising a powerful pull. As a result, the boundaries of the counterrule are quite fluid. There is in our case law much experimentation with good faith notions by trial and error. This may indicate an awareness of the dangers inherent in "well-meaning sloppiness of thought"⁷⁵ which, freely indulged in, would make it exceedingly hazardous to enter into negotiations for a contract.

There is one area of contract law, however, where a considerable body of case law has not regarded a policy of judicial non-intervention as the better part of valor. In the socially very important context of life insurance contracts, a goodly number of courts have been quite daring. They have used *culpa in contrahendo* notions to protect expectations created by applications for life insurance when the insurance company was guilty of unreasonably long delay in processing an application. Insurance companies frequently have been subjected to tort liability for the face amount of the policy if the applicant for insurance was an acceptable risk and had paid the first premium. In a few instances "negligent delay" has been treated as amounting to an acceptance by silence in order to overcome the shortcomings of tort law.⁷⁶

4. *No Serious Intent To Contract.* — Even when an agreement has not been reached the law of contract can ill afford to deny protection to an innocent party against abuse of the privilege to break off. However much the various legal systems may differ in detail as to the scope of precontractual duties, they do not permit, broadly speaking, a party to break off negotiations with impunity in pursuance of a scheme never to come to terms. Under the civil law a party who has used negotiations solely to induce the other party to take a desired course of action and terminates them after his goal has been accomplished, will have to answer in damages to the party whom he has strung along.⁷⁷ Our courts are also able

⁷⁴ *E.g.*, *Truscon Steel Co. v. Cooke*, 98 F.2d 905 (10th Cir. 1938), criticized in 6 U. CHI. L. REV. 305 (1939).

⁷⁵ *Holt v. Markham*, [1923] 1 K.B. 504, 513 (C.A.).

⁷⁶ See *Wadsworth v. New York Life Ins. Co.*, 349 Mich. 240, 84 N.W.2d 513 (1957). For authorities, see Note, 40 COLUM. L. REV. 1071 (1940).

⁷⁷ See March 3, 1925, Oberster Gerichtshof, 7 Entscheidungen des Österreichischen Obersten Gerichtshofes in Zivilsachen 165 (Austrian law); 6(1) PLANIOL & RIPERT at No. 133 (French law); Erman, *Beiträge zur Haftung für das bei*

to protect the victim in such a situation with the help of the doctrines of misrepresentation and promissory estoppel.⁷⁸ Another avenue of recovery is indicated by a recent Court of Claims case involving an alleged violation of the Armed Services Procurement Act of 1947. The act provides that unless the public interest requires the rejection of all bids, the one most advantageous to the Government shall be accepted. The plaintiff, claiming that his bid was rejected in favor of a higher bidder's as a result of arbitrary action taken in bad faith by the contracting officer, sued for damages asking both for bid preparation expenses and loss of profits. A motion to dismiss the complaint on the ground that it did not state a cause of action was denied. Although, as the court held, the act confers no statutory right on plaintiff to sue on the ground that an award was made to a bidder whose bid was not "most advantageous to the Government," nevertheless an invitation for competitive bidding contains an implied promise to give bids fair and honest consideration. As a result, plaintiff, who had submitted the lowest bid, was held entitled to recover, not his lost profits, but expenses in preparing the bid, provided he was able to show "that bids were not invited in good faith, but as a pretence to conceal the purpose to let the contract to some favored bidder" ⁷⁹ Thus, the decision qualifies the traditional rule that a party who invited bids has the right to reject for no reason at all.⁸⁰

C. The Firm Offer Problem

Once negotiations have reached the stage where one of the parties has made an offer, contract law is confronted with delicate problems of adjusting the possibly conflicting interests of the parties. Should an offeree be entitled to rely on an offer or should the offeror, according to the bargain (reciprocity) principle, be

Vertragsverhandlungen, 139 ARCHIV FÜR DIE CIVILISTISCHE PRAXIS 273, 275 (1934) (German law); *Buchser v. Zürich*, Bundesgericht, Oct. 19, 1920, 46(II) S.B.G. 369, 372 (Swiss law).

⁷⁸ See, e.g., *Chrysler Corp. v. Quimby*, 51 Del. 264, 144 A.2d 123 (1958) (promissory estoppel). See also Seavey, *Reliance on Gratuitous Promises and Other Conduct*, 64 HARV. L. REV. 913, 922 (1945).

⁷⁹ *Heyer Prods. Co. v. United States*, 140 F. Supp. 409, 414 (Ct. Cl. 1956). Plaintiff ultimately failed, being unable to establish that the rejection was in bad faith. 177 F. Supp. 251 (Ct. Cl. 1959).

⁸⁰ See, e.g., *Fulton Iron Co. v. Larson*, 171 F.2d 994, 997 (D.C. Cir. 1948), *cert. denied*, 336 U.S. 903 (1949) (bid simply rejectable offer). The lowest bidder for a municipal contract may be, however, entitled to a hearing concerning his responsibility prior to an award of the contract to a higher bidder. See *Arthur Venneri Co. v. Housing Authority*, 29 N.J. 392, 149 A.2d 228 (1959).

free to revoke with impunity so long as the other party has not committed himself by acceptance? Should a middle position be taken? This would mean that a mere offer cannot be relied upon. The offeree who changes his position before acceptance has himself to blame if the offeror changes his mind. But a firm offer, *i.e.*, an offer coupled with a promise to keep it open for a stated period, might be treated differently. All of these solutions have at one time or another been adopted by the various legal systems.⁸¹ Considerations of tradition, of logic, and of utility have been given different weight.

The German law, in its solicitude for the interests of the offeree and in order "to speed up transactions," has gone farthest in breaking with the bargain principle. Unless the offeror by appropriate language has given fair warning to the offeree that the offer is not binding, any offer once communicated is binding.⁸² But an offer lapses if there is no timely acceptance and the risk of loss or delay of an acceptance is on the offeree and not, as under common law, on the offeror.⁸³ The French law has not gone quite so far. An ordinary offer is revocable until accepted. On the other hand, the firm offer, which may set a period for reply either expressly or "by implication," is binding. There is considerable controversy with regard to the consequences of revocation. According to one view revocation is ineffective; according to another it entitles the offeree to reliance damages.⁸⁴

The common law treatment of offers, even of firm offers, still shows the strong influence of the bargain principle. Contract liability, as a rule, is treated as bargain liability. An offer, being without consideration, may be revoked, unless under seal, at any time prior to acceptance even though a stated time is given to the offeree to make up his mind as to the merits of the offer.⁸⁵ This

⁸¹ See 1 RABEL, *DAS RECHT DES WARENKAUFS* § 11 (1936).

⁸² B.G.B. § 145 contains a most important exception to the bargain principle laid down in § 305.

⁸³ See *Household Fire & Carriage Acc. Ins. Co. v. Grant*, 4 Ex. D. 216 (C.A. 1879); B.G.B. §§ 145-51; VON MEHREN, *THE CIVIL LAW SYSTEM* 479-82, 488-92 (1957) (German law).

⁸⁴ See 2 JOSSERAND, *COURS DE DROIT CIVIL POSITIF FRANÇAIS* at Nos. 47-49 (2d ed. 1933) [hereinafter cited as JOSSERAND]; 2 COLIN & CAPITANT, *COURS ÉLÉMENTAIRE DE DROIT CIVIL FRANÇAIS* at Nos. 28, 46 (10th ed. 1948). Commercial offers are firm offers by implication. Feb. 28, 1870, Cour de Cassation (Ch. req.), [1871] *Dalloz Jurisprudence* I. 61.

⁸⁵ *James Baird Co. v. Gimbel Bros.*, 64 F.2d 344 (2d Cir. 1933). The treatment of so-called unilateral contracts, in particular, furnishes excellent illustrations of the bargain theory. *Petterson v. Pattberg*, 248 N.Y. 86, 161 N.E. 428 (1928); *cf.* *Strong v. Sheffield*, 144 N.Y. 392, 39 N.E. 330 (1895).

approach, however, has come up against ever-increasing attack, mainly in the field of so-called unilateral contracts, for not being in line with the demands of good faith in business dealings. A host of doctrines has been employed to protect the offeree who proceeded in good faith to comply with a proposal for a unilateral contract, even though the action taken was insufficient technically to constitute an acceptance.⁸⁶ Of particular interest for our purposes is the emergence of case law differentiating in the interest of fair dealing between various types of unilateral contracts, or demanding that revocation be in good faith, or using doctrines of an implied subsidiary contract, estoppel, and constructive co-operation. Thus for instance, a broker's authority must be revoked in good faith, and not in order to deprive him of his commission.⁸⁷ These techniques, judged in terms of their function, can be classified as instances where *culpa in contrahendo* notions have been used to create binding relations.

The need for protecting the offeree is not so obvious in the field of bilateral contracts, certainly to the extent that means for self-protection are available to him. He has himself to blame for expense incurred in relying on an offer if he has failed to protect himself by dispatching an acceptance, securing a conditional contract or an option. This philosophy underlies Learned Hand's celebrated decision in *James Baird Co. v. Gimbel Bros.*, involving the revocation of a mistaken bid made by a subcontractor to a general contractor.⁸⁸ Revocation came after the general contractor, using defendant's figures, submitted a bid, but before the contract was awarded to him and before he had accepted the defendant's offer in the mode prescribed by the offeror. Plaintiffs,

⁸⁶ See 1 WILLISTON § 60A & n.5 (3d ed. 1957); Note, 33 COLUM. L. REV. 463, 464-66 (1933). RESTATEMENT, CONTRACTS § 45 (1932) shows that the reform movement is not limited to brokerage cases.

⁸⁷ See, e.g., *Branch v. Moore*, 84 Ark. 462, 105 S.W. 1178 (1907); *O'Connell v. Casey*, 206 Mass. 520, 92 N.E. 804 (1910); *Goodman v. Marcol, Inc.*, 261 N.Y. 188, 184 N.E. 755 (1933). See also *Djemil Tahir Erk v. Glenn L. Martin Co.*, 116 F.2d 865 (4th Cir. 1941) (mutual revocation clause ineffective); *Roberts v. May Mills*, 184 N.C. 406, 114 S.E. 530 (1922) (implied supplementary contract not to revoke); RESTATEMENT (SECOND), AGENCY § 454 (1958). Our case law is more inclined to protect the broker who has incurred expenses in bona fide entering upon performance when the brokerage is exclusive or for a definite time. 1 WILLISTON § 60A n.6 (3d ed. 1957).

A parallel development of the good faith doctrine in the performance stage has led courts of equity to forbid the exercise of an option to terminate if done in bad faith. *Philadelphia Storage Battery Co. v. Mutual Tire Stores*, 161 S.C. 487, 159 S.E. 825 (1931).

⁸⁸ 64 F.2d 344 (2d Cir. 1933).

who had to go into the market and had to buy at a higher price, were denied recovery because they "had a ready escape from their difficulty by insisting upon a contract before they used the figures," and, as the court added, "in commercial transactions it does not in the end promote justice to seek strained interpretations in aid of those who do not protect themselves." Plaintiffs' attempt to invoke promissory estoppel was equally unsuccessful. The court, resorting to the bargain theory, had this to say: "the defendant offered to deliver the linoleum in exchange for the plaintiff's acceptance, not for its bid, which was a matter of indifference to it."⁸⁹ This way of disposing of the case is not altogether satisfactory. It takes for granted that "the very fact of making a promise conditional on acceptance [implies] . . . an exclusion of creating an obligation in any other way."⁹⁰ Furthermore, it assumes that the general contractor could have shopped around for better terms after having been awarded the contract, or that he was able to protect himself by arranging for a conditional acceptance. However, conditions in the industry might render such procedures impracticable.⁹¹

As a result of this reasoning it becomes irrelevant, from the court's point of view, that but for the mistake the defendant would not have revoked. Consequently, the court found it unnecessary to go into the question of whether the defendant was careless under the circumstances or whether plaintiff should have realized that the quoted price was too good to be true. Offer law, as applied by the court, protects the careless offeror and there is no room for applying a *culpa in contrahendo* doctrine. The offeror is not forced carefully to prepare his offer. He is safe if he discovers his mistake and revokes so long as there has been no acceptance even though the offeree has used the bid to his detriment. The case of *Robert Gordon, Inc. v. Ingersoll-Rand Co.*⁹² furnishes an illustration. Here the ambiguity of an offer was actually called to the attention of the offeror, who did nothing to correct the mistake; yet he was allowed to escape liability.

A recent California case⁹³ may, however, indicate a new trend.

⁸⁹ *Id.* at 346.

⁹⁰ Patterson, *An Apology for Consideration*, 58 COLUM. L. REV. 929, 961 (1958) (criticizing the Hand opinion).

⁹¹ See Schultz, *The Firm Offer Puzzle: A Study of Business Practice in the Construction Industry*, 19 U. CHI. L. REV. 237 (1952).

⁹² 117 F.2d 654 (7th Cir. 1941).

⁹³ *Drennan v. Star Paving Co.*, 51 Cal. 2d 409, 333 P.2d 757 (1958). Traynor

Judge Traynor, speaking for a unanimous court, denied the defendants the privilege to revoke until acceptance. To be sure, in rationalizing the result, the court found under the circumstances of the case compelling reasons for implying a subsidiary promise not to revoke, supported by foreseeable and injurious reliance in lieu of consideration. But the court added a *culpa in contrahendo* argument by emphasizing that the mistake in the offer which was the reason for defendant's revocation was due to defendant's negligence.

The *Restatement's* efforts to provide courts with guidelines in their attempt to strike an acceptable balance between the principles of reciprocity and fair dealing, and to assure an orderly development of the case law cannot be called wholly successful. The all or nothing formula employed in section 45, making an offer for a unilateral contract irrevocable on part performance, is too blunt an assault on classical consideration dogma. It amounts to an overcorrection if part performance is read to include any part performance, however small.⁹⁴ Section 90, by contrast, is on the whole an admirable attempt to channel the case law on promissory liability. It carefully balances the conflicting interests of promisor and promisee by stressing foreseeability and substantiality of reliance as prerequisites of liability. It admonishes the courts to impose liability only "if injustice can be avoided only by enforcement of the promise." This happy phrase leaves enough room for judicial creativity. Much of the success of this section depends on whether it is read in a flexible spirit. The formula employed is elastic enough to permit a court to vary the quantum of recovery with the facts of the individual case. Recovery, if any, need not be for the expectation interest; the reliance interest may be sufficient to make the victim whole.

D. "Instinct with an Obligation"

There is one line of cases, neglected by the *Restatement*, where the need to balance notions of fair dealing against the requirement

distinguishes *Ingersoll-Rand* on the ground that in *Drennan* the plaintiff had no reason to know of the mistake. But *quaere*.

⁹⁴ See, e.g., *Flynn v. McGinty*, 61 So. 2d 318 (Fla. 1952) (revocation ineffective although agent had spent only \$2 for advertisement); 2 CORBIN § 205 (1963); Fuller & Perdue, *The Reliance Interest in Contract Damages*: 2, 46 YALE L.J. 373, 410-17 (1937). And see *Isern v. Gordon*, 127 Kan. 296, 273 Pac. 435 (1939), in which an exclusive agent unable to perform due to revocation received only reliance damages.

of reciprocity has led the courts into remarkable creativity. They have construed apparently one-sided and therefore not binding transactions into reciprocal bargains so as to protect legitimate expectations. The formula used has found its most felicitous expression in the New York case law. In *Wood v. Lucy, Lady Duff-Gordon*,⁹⁵ defendant, a successful "creator of fashions," had entered into an elaborate agency agreement with plaintiff, giving him the exclusive right to place her designs on sale or to license others to market them. In addition, the contract gave plaintiff exclusive authorization, subject to defendant's approval, to place her endorsement on the designs of others. In return, defendant was to receive one-half of all the profits and revenues derived from any sales plaintiff might make. Violating this agreement, the defendant herself placed her endorsement on fabrics, dresses, and millinery without the plaintiff's knowledge and kept all the profits. When sued for damages, defendant argued that there was no contract, since plaintiff did not bind himself to do anything. Rejecting this argument, Cardozo, seizing upon a phrase coined in an earlier New York case, had this to say:

It is true that he does not promise in so many words that he will use reasonable efforts to place the defendant's indorsements and market her designs. We think, however, that such a promise is fairly to be implied. The law has outgrown its primitive stage of formalism when the precise word was the sovereign talisman, and every slip was fatal. It takes a broader view today. A promise may be lacking, and yet the whole writing may be "instinct with an obligation," imperfectly expressed (Scott, J., in *McCall Co. v. Wright*, 133 App. Div. 62; . . .). If that is so, there is a contract.⁹⁶

Such judicial intervention in the interest of fair business dealing has played a significant role in the evolution of the law governing dealer franchises,⁹⁷ and has determined the outcome of litigation in numerous other types of contracts.⁹⁸

⁹⁵ 222 N.Y. 88, 118 N.E. 214 (1917).

⁹⁶ *Id.* at 90-91, 118 N.E. at 214.

⁹⁷ *Jay Dreher Corp. v. Delco Appliance Corp.*, 93 F.2d 275 (2d Cir. 1937); *Moon Motor Car Co. v. Moon Motor Car Co.*, 29 F.2d 3 (2d Cir. 1928). *But see* *Bushwick-Decatur Motors, Inc. v. Ford Motor Co.*, 116 F.2d 675 (2d Cir. 1940).

⁹⁸ *E.g.*, *Sylvan Crest Sand & Gravel Co. v. United States*, 150 F.2d 642 (2d Cir. 1945); *Carlton v. Smith*, 285 Ill. App. 380, 2 N.E.2d 116 (1936); *Jessup & Moore Paper Co. v. Bryant Paper Co.*, 283 Pa. 434, 129 Atl. 559 (1925).

III. THE MEETING OF MINDS

When dealing with the comparative law of misunderstanding and mistake in the formation of a contract, it is quite tempting to point to the different role assigned to assent under the common and under the civil law. The common law, we are told, emancipating itself about the middle of the last century from the civil law influence, has abandoned the "will" theory in favor of the declaration or "objective" theory of assent.⁹⁹ The expression of assent and not the assent itself has become the essential element of contractual liability. The civil law, by contrast, the argument suggests, is still strongly influenced by a subjective test of intent: the meeting of the minds theory. As a result, to protect the legitimate expectations it has developed the *culpa in contrahendo* doctrine, just as the common law before the advent of the objective theory resorted to estoppel for the protection of a promisee against negligent use of language¹⁰⁰ — one of the kinds of blameworthy conduct creating *culpa in contrahendo* liability. In developing the objective theory of contracts which is presumably divorced from notions of fault the common law has transcended *culpa in contrahendo* notions and has made this doctrine unnecessary.

This way of looking at common and civil law, however plausible, overstates their differences. The common law of contract cannot be explained by the objective theory standing alone. To be sure, there are very powerful statements in the case law advocating or defending the objective theory of contracts,¹⁰¹ and yet the considerable number of common law cases invoking the subjective theory shows that it is surviving the formidable attack of the objectivists. Resort is had to the "discredited" subjectivist theory in situations where the courts feel a rigid application of the objective theory would lead to socially undesirable results.¹⁰²

⁹⁹ 1 WILLISTON §§ 20, 21 (rev. ed. 1936); Patterson, *Equitable Relief for Unilateral Mistake*, 28 COLUM. L. REV. 859, 888-90 (1928).

¹⁰⁰ See Whittier, *The Restatement of Contracts and Mutual Assent*, 17 CALIF. L. REV. 441 (1929); Williston, *Mutual Assent in the Formation of Contracts*, 14 ILL. L. REV. 85 (1919).

¹⁰¹ *E.g.*, Hotchkiss v. National City Bank, 200 Fed. 287, 293 (S.D.N.Y. 1911), *aff'd*, 201 Fed. 664 (2d Cir. 1912), *aff'd*, 231 U.S. 50 (1913).

¹⁰² *E.g.*, Stong v. Lane, 66 Minn. 94, 68 N.W. 765 (1896). The meeting of minds requirement is frequently insisted upon to deny the power to snap up an offer too good to be true. See, *e.g.*, Bell v. Carroll, 212 Ky. 231, 278 S.W. 541 (1925). See generally Ricketts v. Pennsylvania R.R., 153 F.2d 757, 760-65 (2d Cir. 1946) (concurring opinion of Frank, J.).

Similarly, the civil law cannot be explained in terms of the will theory standing alone; a compromise solution combining elements of the objective and the subjective theories of contracts has been found.¹⁰³ We have chosen the areas of misunderstanding and unilateral mistake to demonstrate the influence of notions of *culpa in contrahendo* and good faith in both civil and common law. Even under a regime advocating the objective theory, there is still room, as we shall see, for a *culpa in contrahendo* doctrine.

A. Misunderstanding

Statements are very frequent that in order to have a contract there must be an expression of agreement. In this country orthodox theory actually insists on denying the existence of a contract where overt expressions of assent do not match even though there is a meeting of minds.¹⁰⁴ The civil law, by contrast, would have no difficulty in coming to the opposite conclusion. The practical importance of the issue is well illustrated by *United States v. Braunstein*,¹⁰⁵ where a clerical error made the terms of the offer as repeated in the acceptance differ from those of the original offer, and the court therefore refused to find an acceptance, although one was intended and the offeror was or should have been aware of this fact. The case illustrates the dealing at arm's length philosophy and the security of transactions ideal in the extreme.

The difficulties encountered by rigidly applying an objective theory stand out vividly in cases, such as the celebrated *Raffles v. Wichelhaus*,¹⁰⁶ involving latent ambiguity,¹⁰⁷ frequently called

¹⁰³ See 5 KLING, *op. cit. supra* note 22, § 869, Anm. V, VI (Austrian law); 2 RIPERT & BOULANGER, *TRAITÉ DE DROIT CIVIL D'APRES LE TRAITÉ DE PLANIOL* at Nos. 591-93, 626 (rev. ed. 1957), emphasizing that the French law has attempted to compromise between the two extremes; Feb. 4, 1913, Reichsgericht, 42 J.W. 480; June 4, 1904, 58 R.G.Z. 233, 235.

¹⁰⁴ RESTATEMENT, CONTRACTS § 71, illustration 2 (1932): "A says to B, 'I offer to sell you my horse for \$100.' B, knowing that A intends to offer to sell his cow, not his horse for that price, and that the use of the word 'horse' is a slip of the tongue, replies, 'I accept.' There is no contract for the sale of either the horse or the cow." The better solution is given in *Shubert Theatrical Co. v. Rath*, 271 Fed. 827 (2d Cir. 1921).

¹⁰⁵ 75 F. Supp. 137 (S.D.N.Y. 1947), *appeal dismissed*, 168 F.2d 749 (2d Cir. 1948).

¹⁰⁶ 2 Hurl. & C. 906, 159 Eng. Rep. 375 (Ex. 1864); see *Frigalimont Importing Co. v. B.N.S. Int'l Sales Corp.*, 190 F. Supp. 116 (S.D.N.Y. 1960). While the following discussion concentrates on American and German law, the French law of mistake should be mentioned. It distinguishes between mistakes which prevent a contract from coming into existence (*erreur-obstacle*), of which the *Peerless* case is an example, and mistakes not impairing the validity of the contract to

"mutual misunderstanding" or "mutual mistake." This case dealt with the sale of a cargo of cotton "to arrive ex 'Peerless' from Bombay." Unfortunately, there were two ships with the same name but with different sailing dates. The seller meant a *Peerless* which arrived in December, the buyer a *Peerless* which arrived in October, and refused the December shipment. In the suit by the seller against the buyer for nonacceptance the court gave judgment for the buyer. Under our law the decision makes good sense since there was no meeting of minds (no *consensus ad idem*) and due to the ambiguity of the phrase, the objective theory could not be invoked.¹⁰⁸ Of course, this is only true if we assume that neither party was nor should have been aware of the ambiguity or that both were equally negligent.

The solution denying contractual liability in the absence of *culpa in contrahendo* would be acceptable to a German lawyer. If both parties were negligent the loss would be divided in accordance with the comparative negligence of the parties.¹⁰⁹ If one of the parties knew or should have known that there were two vessels with different sailing dates, then under the American law there would be a contract for the goods from the steamer which the innocent party had in mind. German law, by contrast, would deny that a contract had come into existence.¹¹⁰ But following *culpa in contrahendo* rules, liability would be imposed on the "negligent" party to the extent of the reliance interest of the other party. To sum up, under the German solution of latent ambiguity, the nonassenting party is not liable at all if he was not negligent or if there were no reliance damages; under the American solution, the party who knew or had reason to know the meaning placed on the contract by the other party is bound in

begin with, but entitling the mistaken party to have the contract annulled by court decree (*erreur-nullité*). 2 JOSSE RAND at Nos. 61-64. The latter type of mistake will be dealt with p. 430 *infra*.

¹⁰⁷ Under German categorization, latent ambiguity is called "*versteckter Dissens*." B.G.B. § 155.

¹⁰⁸ If both parties had meant the same *Peerless* (and this could be established) there would be a contract despite ambiguity. RESTATEMENT, CONTRACTS § 71, illustration 1 (1932); *accord*, Oct. 29, 1937, Reichsgericht, 67(I) J.W. 590.

¹⁰⁹ See B.G.B. § 155; Jan. 17, 1908, 68 R.G.Z. 6 (mutual misunderstanding as to message, no negligence on either side). The fact situation reminds us of *Falck v. Williams*, [1900] A.C. 176 (P.C. 1899). See also April 5, 1922, 104 R.G.Z. 265, 267 (must be latent ambiguity in declarations exchanged; misunderstanding primarily caused by defendant).

¹¹⁰ Compare RESTATEMENT, CONTRACTS § 71, illustration 1 (1932), with 1 STAUDINGER § 155, Anm. 2, 5.

accordance with the objective theory of contracts. But notions of good faith and *culpa in contrahendo* often furnish the justification for applying the objective theory. Cases denying the existence of a contract or recovery typically stress either that both parties acted in good faith or that the losing party was lacking in good faith or was guilty of negligent use of language.¹¹¹

B. Unilateral Mistake and Culpa in Contrahendo

Ever since Jhering's famous and successful attack on the will theory, the problem of how to deal with unilateral mistakes has played a major role in the evolution of *culpa in contrahendo* in civil law countries. The civil law system, on the whole, has seen no reason for a radical break with consensualist tradition (the meeting of minds theory) in favor of the objective theory of contracts. Equitable arguments, the civilians argue, can be advanced in favor of either theory.¹¹² To be sure, expectations created by conduct are worthy of protection. And yet, as the civil law literature emphasizes, the solution of the mistake problem advocated by the objective theory of contracts with its indiscriminate protection of the promisee is too harsh on the promisor and quite wasteful.¹¹³ There is no need for protecting the expectation interest *à outrance*, pushing through a contract tarnished by mistake, particularly so long as the promisee has not acted in reliance on its validity. Broadly speaking, the civil law, influenced by such considerations, has steered a middle course between will and objective theories, attempting to combine the good features of each approach. It has narrowed the domain of operative unilateral mistake and has used the *culpa in contrahendo* principle to create a strong incentive for avoiding careless manifestations of assent and to protect the innocent party against loss.

1. *The Civil Law.* — The meagre and obscure provisions of the French Civil Code dealing with mistake are strongly influenced by consensualist tradition.¹¹⁴ Article 1108 enumerates as one of the

¹¹¹ See *D. S. Cage & Co. v. Black*, 97 Ark. 613, 618-19, 134 S.W. 942, 945 (1911); *Rupley v. Daggett*, 74 Ill. 351 (1874) (no contract: ambiguous language; intimation that buyer was or should have been aware of seller's interpretation); *cf. Dickey v. Hurd*, 33 F.2d 415, 418 (1st Cir.), *cert. denied*, 280 U.S. 601 (1929) (seller must correct buyer's misinterpretation of ambiguous offer); *Field-Martin Co. v. Freun Milling Co.*, 210 Minn. 388, 298 N.W. 574 (1941).

¹¹² See 2 ENNECCERUS § 166 II; 2 COLIN & CAPITANT at Nos. 592, 593; 1 VON TUHR-SIEGWART, *op. cit. supra* note 22, § 36 (1942).

¹¹³ 2 ENNECCERUS § 166 II n.3. For similar arguments in this country see Whittier, *supra* note 100, at 441-46.

¹¹⁴ See CODE CIVIL arts. 1108-10, 1117, 1131; 2 JOSSE RAND at Nos. 58, 59.

essential conditions for the validity of a contract the consent of the party who binds himself. Article 1109 declares that there is no valid contract if consent was given by error, but this provision is qualified in article 1110 with regard to two important types of mistake.¹¹⁵ An error as to the object (*error in objecto sive corpore*) is not a ground for nullity of a convention unless it goes to the very substance of the thing forming the object of the contract, and an *error in persona* is inoperative unless the identity of the person is one of the convention's main grounds. The code makes no provision for the protection of the nonmistaken party. To safeguard his interests, case law and literature have narrowly circumscribed *error in substantia*.¹¹⁶ Under the prevailing view the mistaken party is entitled to relief only if his factual assumption constituted the dominant motive, the principal consideration, for making the contract, and the other party was aware of this fact.¹¹⁷ Furthermore, due to the influence, however indirect, of *culpa in contrahendo* notions there is a tendency either to restrict relief to cases of excusable error or to compensate the innocent party by awarding him reliance damages. But no protection will be accorded to a party aware of the fact that the other party was mistaken as to a matter regarded by him as essential.¹¹⁸

Under German law a unilateral mistake entitles the mistaken party to avoid a legal transaction only under certain conditions. First, the mistaken party would not have made the "declaration of intention" had he known the true facts and reasonably appre-

¹¹⁵ But art. 1110 does not cover the whole field of error; see arts. 1131, 1304. Errors in expression (slips of the pen) and errors in calculation, if palpable, entitle the mistaken party to rectification (the contract is not voidable). 6(1) PLANIOL & RIPERT at Nos. 175, 190.

¹¹⁶ Under the prevailing view, a mistake as to the genuineness of a pearl necklace, Nov. 5, 1929, Cour de Cassation (Ch. req.), [1929] Dalloz Jurisprudence I. 539, or of an art object, July 25, 1900, Cour de Cassation (Ch. civ.), [1902] Sirey Recueil Général I. 317, allows relief, provided the buyer can establish his mistake by showing that he has paid a price appropriate for the genuine article. See Thayer, *Unilateral Mistake and Unjust Enrichment as a Ground for the Avoidance of Legal Transactions*, in HARVARD LEGAL ESSAYS 467, 473 (1934). Relief will not be granted for nonessential mistake, mere mistake in value, or a mistake in motivation, which relates to an assumption not part of the contract (*erreur antérieur au contrat*). 2 COLIN & CAPITANT at No. 658. But see the *laesio enormis* rule of art. 1674 which permits one who has sold his real property, mistakenly or not, for less than five-twelfths of its value to rescind.

¹¹⁷ A minority view requires mutuality of mistake. 2 JOSSERAND at No. 69. For the majority, a unilateral mistake entitles to relief when it enters the *champ contractuel*, or, in common law language, becomes an implied term going to the root of the contract. 6(1) PLANIOL & RIPERT at No. 177.

¹¹⁸ 6(1) PLANIOL & RIPERT at No. 189.

ciated the situation. Second, the mistake to be operative must fall under three specifically enumerated categories. The first two are mistakes in respect to the declaration itself. In the strange language of section 119(1) of the German Civil Code the party must either be mistaken as to its purport or not have intended to make a declaration of that purport at all. The third type of mistake, referred to in section 119(2), is a mistake concerning any characteristic of the person or subject matter of the transaction that is considered essential in ordinary affairs.¹¹⁹ A mistake in value according to the case law is not essential.¹²⁰ Nor is an error in motive unless it affects essential qualities.¹²¹ Errors in calculation have played a significant role in the case law. Despite strong criticism by the literature they have been classified by the *Reichsgericht* not as errors in motive, but as errors in purport, and therefore operative, provided the negotiations have brought home to the other party that the price stated was intended to be the price resulting from correct calculation.¹²²

The privilege to rescind presupposes neither palpability of the mistake, nor the absence of negligence. The other party, however, is entitled to receive compensation from the avoiding party even though the latter was not negligent.¹²³ The liability of the mistaken party to make compensation is absolute. Strictly speaking, therefore, as we are told, liability is not predicated on *culpa in contrahendo*.¹²⁴ Yet, the measure of liability is limited to the reliance interest traditionally associated with the *culpa in contrahendo* principle. Recovery cannot exceed the expectation interest. If the other party knew or should have known of the mistake, no protection will be granted.¹²⁵

The solution of the mistake problem offered by the Swiss law is

¹¹⁹ See the discussion of § 119 in 5 WILLISTON §§ 1600C-D (rev. ed. 1937).

¹²⁰ Nov. 9, 1906, 64 R.G.Z. 266, 269.

¹²¹ A mistake in motive (*Irrtum in Beweggrund*), i.e., a mistake not causing a discrepancy between will and declaration of intention, is irrelevant, unless covered by § 119(2). The buyer of a wedding present cannot void if there is no wedding. 1 ENNECCERUS § 166(2). Section 119(2) has been applied to, e.g., mistake as to a debtor's solvency in a credit transaction, Oct. 18, 1907, 66 R.G.Z. 385. Mistake in motive has come under increasing attack. See Titze, *Vom Sogenannten Motivirrtum*, 2 FESTSCHRIFT FÜR HEYMANN 72 (1940), recommending analysis in terms of good faith and accepted standards of fair dealing.

¹²² Dec. 2, 1939, 162 R.G.Z. 198; Dec. 17, 1920, 101 R.G.Z. 107, 108; Nov. 9, 1906, 64 R.G.Z. 266.

¹²³ B.G.B. § 122.

¹²⁴ 1 LARENZ, LEHRBUCH 40.

¹²⁵ B.G.B. § 122, paras. 1, 2.

a good deal more flexible. Only material (essential) mistakes are to be considered. The broad provisions of the Swiss Code of Obligations give the courts considerable leeway in determining the required materiality of the mistake and the measure of recovery.¹²⁶ Article 24 of the Code of Obligations enumerates a list of situations where the mistake is to be regarded as essential but adds that it is not exclusive. The list includes a mistake as to the nature of the transaction, the identity as opposed to the mere quality of the person or object, a substantial mistake as to the quantum of the promised performance or counterpromise¹²⁷ and a mistake regarding a fact assumed as a necessary basis of the contract in the light of good faith and fair dealing.¹²⁸ An *error calculi* entitles the mistaken party to rectification if the agreement discloses the means of arriving at the price. In contrast to the German law, the duty to compensate the other party presupposes fault, and in an appropriate case the court may give protection to the expectation interest. Relief may be denied to the mistaken party if the granting of relief would bring about a conflict with notions of good faith and fair dealing, particularly if the other party is willing to let the contract stand in accordance with intentions of the mistaken party.¹²⁹

2. *The Common Law.*—The civil law treatment of mistake, particularly unilateral mistake, as worked out by the German law, has come in for a good deal of criticism by Anglo-American writers in comparative law. Three arguments have been made in the main: First, under the civil law, its critics tell us, no weight is given to the “psychological effects of the promise and of its subsequent repudiation, upon the promisee, in cases where the promisee has done no overt prejudicial act in reliance upon the promise. The promisee may have made his plans and even have altered his external conduct in innumerable ways in reliance upon the promise, and yet such injuries go uncompensated. Non-economic . . . interests and mental injuries are not taken into account.” Since it is most difficult to prove and to evaluate the promisee’s disappointed expectations, the common law courts justifiably were driven to adopt the other alternative, namely, to

¹²⁶ GUHL, *DAS SCHWEIZERISCHE OBLIGATIONENRECHT* §§ 15, 16 (5th ed. 1956).

¹²⁷ *E.g.*, a mistake as to the size of land in a sale or lease contract, *Meier v. Zimmermann*, Bundesgericht, May 24, 1913, 39(II) S.B.G. 238; *Müller v. Heim*, Bundesgericht, Oct. 2, 1914, 40(II) S.B.G. 534, 536.

¹²⁸ GUHL, *op. cit. supra* note 126, at 116–117.

¹²⁹ SCHWEIZERISCHES OBLIGATIONENRECHT arts. 25, 26 (Swit.).

allow the promisee to recover the standardized value of his bargain.¹³⁰ Second, the common law cannot afford to adopt the civil law solution of the mistake problem, since it has no *culpa in contrahendo* doctrine.¹³¹ Third, by subjecting to liability the party responsible for the mistake, the objective theory of contracts creates a powerful incentive to avoid careless manifestations of assent.¹³² In short, the ideal of security of transactions demands an objective theory of contracts and a confinement of operative unilateral mistake within narrow limits. Thus, the impression of a deep cleavage emerges, at least on the doctrinal level, between the civil law and the common law, the civil being identified with the will theory, the common law with the objective theory of contracts.¹³³

Indeed, there is the powerful authority of the *Restatement of Contracts* which says that the mistake of only one party (as against mutual mistake which is operative) does not of itself render the transaction voidable even though it forms the basis on which the mistaken party enters into the transaction.¹³⁴ But there is a widening countercurrent of case law which stresses factors relevant under the *culpa in contrahendo* doctrine. Protection to

¹³⁰ Patterson, *Equitable Relief for Unilateral Mistake*, 28 COLUM. L. REV. 859, 887-88 (1928). See the strong arguments against weakening the stability and definiteness of bilateral contracts in Note, 27 COLUM. L. REV. 60, 66 (1927).

¹³¹ Lawson, *Error in Substantia*, 52 L.Q. REV. 79, 103 (1936); see 100 U. PA. L. REV. 753, 755 (1952).

¹³² See *Tamplin v. James*, 15 Ch. D. 214, 221 (C.A. 1880).

¹³³ See *Hotchkiss v. National City Bank*, 200 Fed. 287, 293 (S.D.N.Y. 1911), *aff'd*, 201 Fed. 664 (2d Cir. 1912), *aff'd*, 231 U.S. 50 (1913); *Frederick E. Rose (London), Ltd. v. William H. Pim Jnr. & Co.*, [1953] 2 Q.B. 450, 461; *Solle v. Butcher*, [1950] 1 K.B. 671, 691; *Smith v. Hughes*, L.R. 6 Q.B. 597, 607 (1871); 1 WILLISTON § 95 (3d ed. 1957); *Shatwell, The Supposed Doctrine of Mistake in Contract: A Comedy of Errors*, 33 CAN. B. REV. 164, 169 (1955). For a criticism of the objective theory, see, e.g., *Martin v. Campanaro*, 156 F.2d 127 (2d Cir.), *cert. denied*, 329 U.S. 759 (1946). For the attitude of equity, see 2 CHAFFEE & SIMPSON, CASES ON EQUITY 1313 (1st ed. 1934).

¹³⁴ RESTATEMENT, CONTRACTS § 502 (1932), criticized in 3 CORBIN § 608 (rev. ed. 1960), which points out that much support for this position is only dictum. A unilateral mistake for which relief will be denied arises when one party is unaware of the other party's mistake, i.e., is mistaken only as to the other party's state of mind. 5 WILLISTON § 1570A (rev. ed. 1937). The distinction between mutual and unilateral mistake makes sense when reformation is requested. Reformation of a unilateral mistake, unlike a mutual mistake, would create a contract which one of the parties never intended. 5 WILLISTON § 1548 (rev. ed. 1937). *But see A. Roberts & Co. v. Leicestershire County Council*, [1961] Ch. D. 555, (reformation granted when unilateral mistake palpable). According to *Garrard v. Frankel*, 30 Beav. 445, 54 Eng. Rep. 961 (Ch. 1862), a party aware of a mistake has the option to accept reformation or compensate the mistaken party.

the victim of mistake has always been accorded when the mistake was caused by fraud or misrepresentation of the other party. But the courts have increasingly come to realize that the objective theory of contracts must give way whenever the security-of-transactions principle comes into conflict with notions of good faith and fair dealing. Protection, therefore, is no longer limited to the fraud and misrepresentation situations. A party will not be permitted unconscionably to profit at the expense of another who, as he knows, has made a "costly error";¹³⁵ and the domain of palpable mistake has come to include situations where the mistake should have been known.¹³⁶ Since many courts, to accomplish results which they have regarded as fair and just, have refused mechanically to apply the unilateral-bilateral mistake dichotomy, the line between hard bargains which are enforceable and those affected by operative mistake has become quite fluid.¹³⁷

Over the last decades notions of good faith and fair dealing have undergone a steady process of further expansion, particularly in the field of public construction contracts. By means of the notion of unconscionability,¹³⁸ bidders for public construction contracts whose bids were based on "honest" errors in calculation or computation were granted relief provided the errors were "excusable," had serious financial consequences, and the nonmistaken party had not acting in reliance substantially changed his

¹³⁵ 17 U. CHI. L. REV. 725, 727 (1950); see *United States v. Jones*, 176 F.2d 278 (9th Cir. 1949); *Davis v. Reisinger*, 120 App. Div. 766, 105 N.Y. Supp. 603 (1907). As these cases show, that "the offeree will not be permitted to snap up an offer that is too good to be true," 1 WILLISTON § 94, at 343 (3d ed. 1957), applies not only to mistaken price quotations.

¹³⁶ *E.g.*, *Monroe Mfg. Co. v. United States*, 143 F. Supp. 449 (E.D. Mich. 1956); *Geremia v. Boyarsky*, 107 Conn. 387, 140 Atl. 749 (1928); *Webster v. Cecil*, 30 Beav. 62, 54 Eng. Rep. 812 (Ch. 1861). *But see* *Saligman v. United States*, 56 F. Supp. 505, 507 (E.D. Pa. 1944) (no protection when price "in line"). Failure to inform the other party of a palpable mistake renders the blame-worthy party liable for the value of the other party's performance. *Hudson Structural Steel Co. v. Smith & Rumery Co.*, 110 Me. 123, 85 Atl. 384 (1912).

¹³⁷ The difficulty of the distinction is illustrated by the examples in RESTATEMENT, CONTRACTS § 472, illustration 4 (1932), and by RESTATEMENT, RESTITUTION § 12 (1937). According to RESTATEMENT, CONTRACTS § 472(1)(b) & comment b (1932), a unilateral mistake known to the other party, like a mutual mistake, is operative when "vital." Thayer has sensibly suggested that rescission for mistake is intimately connected with, and should find its limitation in, unjust enrichment. Thayer, *supra* note 116, at 473, 477-78; see *Peerless Cas. Co. v. Housing Authority*, 228 F.2d 376, 381 (5th Cir. 1955); Sharp, *Williston on Contracts*, 4 U. CHI. L. REV. 30, 38 (1936).

¹³⁸ The emphasis on unconscionability goes back to the Redfield edition of 1 STORY, EQUITY JURISPRUDENCE § 138(i) (9th ed. 1866).

position to his detriment.¹³⁹ The mere fact that an offer of a higher bidder had to be accepted has not been regarded as a change of position fatal to relief, particularly if due to statute or charter provision the other bids were still outstanding. Occasionally, relief has even been granted where the mistake was impalpable.¹⁴⁰ Where relief was denied, the unilateral character of the mistake often has been regarded as only one of the factors to be considered. Stress has been laid on the absence of clear and convincing evidence as to the honesty and seriousness (materiality) of the mistake, the fact that the *status quo* could not be restored, and the "negligence" of the mistaken party claiming relief.¹⁴¹ An increasing number of decisions have even taken the position that a mere slight degree of negligence will not bar relief.¹⁴²

To be sure, many of the mistake cases where relief was granted involved public construction contracts in which plaintiff faced forfeiture of a deposit or bond statutorily required to secure a bid.¹⁴³ But the liberalization of the objective theory of contracts has not been confined to these construction transactions. Nor has it been limited to releases.¹⁴⁴ Relief has been granted for bona

¹³⁹ *E.g.*, *M. F. Kemper Constr. Co. v. Los Angeles*, 37 Cal. 2d 696, 235 P.2d 7 (1951) (bid irrevocable under charter); *Baltimore v. DeLuca-Davis Constr. Co.*, 210 Md. 518, 124 A.2d 557 (1956) (deposit recovered: mistaken bid less than half of engineer's estimate, plaintiff not responsible bidder); *Connecticut v. F. H. McGraw & Co.*, 41 F. Supp. 369 (D. Conn. 1941) (erroneous reading of specifications).

¹⁴⁰ *St. Nicholas Church v. Kropp*, 135 Minn. 115, 160 N.W. 500 (1916). See also *Lubell, Unilateral Palpable and Impalpable Mistake in Construction Contracts*, 16 MINN. L. REV. 137 (1932).

¹⁴¹ See *Steinmeyer v. Schroepfel*, 226 Ill. 9, 80 N.E. 564 (1907), maintaining that no distinction can be drawn between an error in addition and one in computing profits; *Glamorgan Pipe & Foundry Co. v. Washington Suburban Sanitary Comm'n*, 183 F. Supp. 840 (D. Md. 1960).

¹⁴² *E.g.*, *James T. Taylor & Son v. Arlington Independent School Dist.*, 160 Tex. 617, 624, 335 S.W.2d 371, 375 (1960): Negligence must amount to violation of "a positive duty in making up a bid, taking into consideration the nature of the transaction and the position of the opposite contracting party . . ."; *Bromagin & Co. v. City of Bloomington*, 234 Ill. 114, 84 N.E. 700 (1908) (time pressure on contractor relevant).

¹⁴³ Even though the public authority was entitled by statute to retain the deposit as liquidated damages, recovery was permitted when the mistake was discovered. Even a clause denying release "on account of errors" was ignored by the court in *Board of Regents v. Cole*, 209 Ky. 761, 273 S.W. 508 (1925), and given a limited interpretation in *M. F. Kemper Constr. Co. v. Los Angeles*, 37 Cal. 2d 696, 235 P.2d 7 (1951). The cases granting relief for the most part involved bills in equity to cancel the bid, but the mistake should also be available as an equitable defense in an action at law for damages. See 3 CORBIN § 609 (rev. ed. 1960).

¹⁴⁴ For an admirable discussion of relief for unilateral mistake in releases of

fide and material mistake of expression where the mistake concerned the essential terms of a writing;¹⁴⁵ or where a buyer of land innocently bought the wrong piece, or was mistaken as to the availability of access roads.¹⁴⁶ Even in the field of sales of goods where one might expect strict adherence to the ideal of security, courts have accorded relief from mistakes as to substance (identity of the subject matter), as contrasted with mere quality,¹⁴⁷ unless the risk of mistake was assumed by the party seeking relief according to the "intent of the contract."¹⁴⁸ While miscalculations of prices or errors as to quantity bought or sold have often been regarded as inoperative, several of the decisions denying relief have emphasized the fact that the transaction was executed or a change of position had taken place.¹⁴⁹ The significance of these statements qualifying traditional mistake doctrine is difficult to assess. It is quite tempting to dismiss them as dicta gratuitously thrown in. And yet they may express an uneasy awareness of tension between the living law of contracts and case law. Unfortunately, we know far too little about the former. But there is enough information to indicate that the business community does not always regard a contract as a "steel chain" but often "only as a tentative arrangement, even after the legal requirements of contract have been satisfied." To the extent that the business community permits cancellation with impunity, or upon payment of reliance damages (reimbursement of expenses incurred), the strict rules of contract law with regard to unilateral mistake have lost

injury claims, see *Denton v. Utey*, 350 Mich. 332, 86 N.W.2d 537 (1957). Mutuality of mistake as to degree of injury, where necessary, has often been inferred from the payment of a small sum for a serious injury. *E.g.*, *Clancy v. Pacenti*, 15 Ill. App. 2d 171, 145 N.E.2d 802 (1957) (collecting authorities).

¹⁴⁵ *Kappelman v. Bowie*, 201 Md. 86, 93 A.2d 266 (1952); *Miller v. Stanich*, 202 Wis. 539, 233 N.W. 753 (1930).

¹⁴⁶ *E.g.*, *Goodrich v. Lathrop*, 94 Cal. 56, 29 Pac. 329 (1892), applying CAL. CIVIL CODE §§ 3407, 3408; *Perlmutter v. Bacas*, 219 Md. 406, 149 A.2d 23 (1959) (seller not prejudiced beyond loss of bargain). *Contra*, *Beebe v. Birkett*, 109 Mich. 663, 67 N.W. 966 (1896) (buyer could have discovered his mistake by ordinary care).

¹⁴⁷ *Sherwood v. Walker*, 66 Mich. 568, 33 N.W. 919 (1887). The notion of a clear-cut distinction is justifiably criticized in ANSON, CONTRACTS 249-51 (21st ed. 1959). To expand operative mutual mistake, the courts not infrequently have replaced an identity of subject matter by a basic fact test. Note, 35 HARV. L. REV. 757 (1922).

¹⁴⁸ *Backus v. MacLaury*, 278 App. Div. 504, 106 N.Y.S.2d 401, *appeal denied*, 278 App. Div. 1043, 107 N.Y.S.2d 568 (1951).

¹⁴⁹ *E.g.*, *Tatum v. Coast Lumber Co.*, 16 Idaho 471, 101 Pac. 957 (1909); *Cargill Comm'n Co. v. Mowery*, 99 Kan. 389, 396, 161 Pac. 634, 636 (1916); *Griffin v. O'Neil*, 48 Kan. 117, 29 Pac. 143 (1892).

some of their vigor.¹⁵⁰ Unfortunately common law courts have generally felt that they had no alternative other than to enforce or deny a contract. Equity, on the other hand, has occasionally granted rescission or refused specific performance on payment of reliance damages.¹⁵¹

To sum up, in attempting to find acceptable solutions mediating between the legitimate interests of both promisor and promisee, traditional doctrine in this country has been redefined by a body of case law too large to be ignored. In this process of refinement of our law of contract, *culpa in contrahendo* and notions of unjust enrichment have played a significant role. While in the civil law countries *culpa in contrahendo* has been used in large measure to mitigate the will theory, the common law starting from the other end has employed it as one of its weapons to soften the rigor of the objective theory of contracts. In this country the process of mitigation has found further manifestation in the notion that a mistaken party should be protected against oppressive burdens when rescission would impose no substantial hardship on the party seeking enforcement of the contract. Thus a link has been established between operative mistake and unjust enrichment. Here is an instance where the common law will look into adequacy of consideration. This variance from the general rule is not surprising, since the ordinary interest in protecting a price mutually arrived at is not present here.

C. Fraud and Misrepresentation

Fraud and misrepresentation are types of conduct which clearly illustrate the operation of the *culpa in contrahendo* principle. Their place is in the category of mistake; the person guilty of fraud or misrepresentation either creates or takes advantage of mistake. The role within the contract system played by the two concepts will depend in large measure on its attitude with regard to unilateral mistake. A law of contracts which broadly allows rescission for unilateral mistake obviously will assign to fraud and

¹⁵⁰ Patterson, *supra* note 130, at 881; see Macauley, *Non-Contractual Relations in Business: A Preliminary Study*, 28 AM. SOCIOLOGICAL REV. 55, 60-62 (1963).

¹⁵¹ Board of Regents v. Cole, 209 Ky. 761, 273 S.W. 508 (1925); Wallace v. McGirr, [1936] N.Z.L.R. 483 (1936). Where bids for public construction are statutorily irrevocable courts have usually limited the public authority's recovery to the deposit as liquidated damages. A. J. Colella, Inc. v. County of Allegheny, 391 Pa. 103, 137 A.2d 265 (1958).

certainly to misrepresentation a smaller function than will a legal order which regards unilateral mistake as either inoperative or confines its relevance within narrow limitations. The constant emphasis on the fraud or misrepresentation exception to the unilateral mistake rule in the common law literature is therefore not surprising. Nor is the tendency to expand the category of palpable error. But it would be rash to assume that in the civil law countries, by contrast, fraud and misrepresentation are relevant only in the context of damages. Despite the more liberal attitude of the civil law there are certain types of unilateral mistakes which remain unprotected unless they are caused by fraud. This is true, for instance, with regard to a so-called mistake in motive.¹⁵² Non-fraudulent misrepresentation also, as we shall see, is not a superfluous category because of the treatment of unilateral mistake.

1. *Concealment and Nondisclosure.* — Fraudulent misrepresentation has often been dealt with in both common and civil law literature. There is no need therefore to cover it in detail once more. However, one complex of problems intimately connected with the fraud issue deserves special attention for purposes of our paper: nondisclosure and concealment. An investigation of the scope of the "duty to disclose" on a comparative law basis is most rewarding; it leads us straight to the heart of the philosophy underlying the law of contracts. Particular emphasis will be given to the German law because its case law and literature contain a rich discussion of the issues involved.

Influenced by notions of good faith and fair dealing, the German law, as we recall, appears to have gone to extremes in imposing upon a party to a contract the duty to disclose material matters inaccessible to the other party.¹⁵³ But on closer examination of case law and literature we discover that the first impression may well be misleading. By and large courts have been well aware of the natural antagonism of interests between seller and buyer. Despite the sweeping language occasionally employed,¹⁵⁴ the courts have refrained from imposing a duty to disclose indiscriminately and wholesale. Rather, the scope of the duty varies with the type of transaction involved and with the circumstances of the individual case. Stricter demands of frankness are made in transactions of a fiduciary nature (mandate, partnership, insurance)

¹⁵² 2 JOSSERAND at No. 98 (French law); see 5 WILLISTON § 489 (rev. ed. 1937).

¹⁵³ See p. 405 *supra*.

¹⁵⁴ March 20, 1940, Reichsgericht, 17 Hoechststrichterliche Rechtsprechung No. 69 (1941).

than in sales and leases.¹⁵⁵ On the other hand fiduciary relationships do not form a closed system. They can come into existence *ad hoc* by virtue of the surrounding circumstances. The buyer, for instance, may indicate to the seller that he is relying on him as an expert.¹⁵⁶ Or, if one of the parties is aware that the other is unable to understand the contents of a writing because of a physical handicap, he is under a duty to enlighten the handicapped person.¹⁵⁷ Questions asked may enlarge the duty to disclose. The seller of a house, for instance, asked about the quality of its structure, is under a duty to disclose all structural defects; he has to disclose all matters whose materiality to the buyer becomes evident on the basis of the latter's question.¹⁵⁸

2. *Caveat Emptor*. — The attitude of the common law appears to be quite different, a phenomenon often commented upon during the formative period of the case law of contracts in opinions fully aware of the civil law. The common law, we are told, in contrast to the civil law, which follows the maxim of *caveat venditor*, pays obeisance to the maxim of *caveat emptor*.¹⁵⁹ To be sure, the famous principle has found its most frequent expression in nineteenth-century sales law. The celebrated case of *Smith v. Hughes* informs us that "there is no legal obligation on the vendor to inform the purchaser that he is under a mistake, not induced by the act of the vendor."¹⁶⁰ And an eminent text states that the seller may let the buyer cheat himself *ad libitum* but must not actively assist him in cheating himself.¹⁶¹

Caveat emptor, backed up by powerful arguments of public policy, has greatly retarded the evolution of implied warranties. Parsons represents the typical attitude of classical sales law:

If there be no express warranty, the common law, in general, implies none. Its rule is, unquestionably, both in England and in this

¹⁵⁵ 1 ENNECERUS § 174; 1 STAUDINGER § 123, Anm. 22, citing authorities.

¹⁵⁶ 2 STAUDINGER § 433, Anm. 17.

¹⁵⁷ Nov. 16, 1933, Oberlandesgericht Stuttgart, 63(I) J.W. 571 (1934).

¹⁵⁸ Jan. 2, 1929, Reichsgericht, 21 WARNEYER, JAHRBUCH DES ENTSCHEIDUNGEN at No. 45 (1929).

¹⁵⁹ The often asserted dichotomy between *caveat venditor* and *caveat emptor* is misleading, for the latter may also apply to the seller. See Harris v. Tyson, 24 Pa. 347, 359-60 (1855). For a comparative analysis emphasizing French law, see Morrow, *Warranty of Quality: A Comparative Survey*, 14 TUL. L. REV. 327, 329 (1940).

¹⁶⁰ L.R. 6 Q.B. 597, 607 (1871): The buyer's wrong impression was obvious to the seller. See CHESHIRE & FITOFT, CONTRACTS 216 (5th ed. 1960).

¹⁶¹ 1 PARSONS, CONTRACTS 461 (3d ed. 1857). Williston appears to agree. 5 WILLISTON § 1497 (rev. ed. 1937).

country, *caveat emptor*,—let the purchaser take care of his own interests. This rule is apparently severe, and it sometimes works wrong and hardship; and it is not surprising that it has been commented upon in terms of strong reproach But the assailants of this rule have not always seen clearly how much of the mischief apparently springing from it arises rather from the inherent difficulty of the case. As a general rule, we must have this or its opposite; and we apprehend that the opposite rule,—that every sale implies a warranty of quality,—would cause an immense amount of litigation and injustice. It is always in the power of a purchaser to demand a warranty; and if he does not get one, he knows that he buys without warranty, and should conduct himself accordingly; . . . and he must not ask of the law to indemnify him against the consequences of his own neglect of duty.¹⁶²

The philosophy of *caveat emptor*, the legal profession was convinced, was not in conflict with notions of good and fair dealing. The duties of good faith, Chancellor Kent tells us, must be reconciled with the “claims of convenience . . . to every extent compatible with the interests of commerce.” If the diligent is not to be deprived of the fruits of his superior skill and knowledge acquired by legitimate means the law cannot afford to go to the “romantic length of giving indemnity against the consequences of indolence and folly, or a careless indifference to the ordinary and accessible means of information.”¹⁶³

The sentiments expressed in these statements were in keeping with the temper of the times. Small wonder that the authority of *caveat emptor* was not confined to sales law. It is, as *Bell v. Lever Bros.* assures, a principle of universal validity.¹⁶⁴ In the absence of a fiduciary obligation parties may put each other at arm's length.

¹⁶² 1 PARSONS, *op. cit. supra* note 161, at 460-61. Before Lord Mansfield the common law appears to have been that a sound price warrants a sound commodity. *Stuart v. Wilkins*, 1 Doug. 18, 99 Eng. Rep. 15 (K.B. 1778), established that the seller is not responsible for any defects absent fraud or express warranty.

¹⁶³ 2 KENT, COMMENTARIES 485 (12th ed. 1873); see *Hays v. Meyers*, 139 Ky. 440, 442-43, 107 S.W. 287, 288 (1908). Also, “the bargaining process on a ‘free market’ would become tedious and unstable if each bargainer had to tell the other all his reasons for the price he asks or bids.” PATTERSON, ESSENTIALS OF INSURANCE LAW 447 (2d ed. 1957).

¹⁶⁴ [1932] A.C. 161, 227 (1931). Here an employee negotiating severance pay was held under no duty to inform his employer of facts permitting discharge without compensation. Other colorful cases have found no duty to disclose the following: a mine under seller's land, known only to buyer: *Fox v. Mackreth*, 2 Bro. C.C. 400, 420, 29 Eng. Rep. 224, 234 (Ch. 1788); insolvency of a buyer on credit if he intends to pay: *Nichols v. Pinner*, 18 N.Y. 295 (1858). See also *Laidlaw v. Organ*, 15 U.S. (2 Wheat.) 178, 195 (1817).

This attitude has profoundly affected the law of concealment. Silence as such, *i.e.*, mere nondisclosure, does not constitute concealment. Active suppression is required.¹⁶⁵ As the *Restatement of Contracts* and a considerable number of modern cases illustrate, the impact of these ideas is noticeable to this day.¹⁶⁶ But the moral and emotional appeal of *caveat emptor* has lost much of its force. Our attitude with regard to good faith and fair dealing has undergone or is undergoing a profound change. As a result *caveat emptor* is in retreat.

3. *Counterrules to Caveat Emptor.*— Even in its heyday the great maxim had its limitations in the form of counterrules and exceptions and these are continuously gaining in strength. However strong the sentiments in favor of *caveat emptor*, our case law never failed to emphasize that the law must afford reasonable protection against fraud in dealing. And it has become increasingly difficult to draw a clear line between “active suppression” which constitutes fraud, and mere silence which does not. In the language of Lord Eldon, “a very little is sufficient to affect the application of [*caveat emptor*] If a word, if a single word be dropped which tends to mislead the vendor, that principle will not be allowed to operate.”¹⁶⁷ And a New York case informs us that “it depends upon the circumstances of each case whether failure to disclose is consistent with honest dealing. Where failure to disclose a material fact is calculated to induce a false impression, the distinction between concealment and affirmative misrepresentation is tenuous. Both are fraudulent.”¹⁶⁸ Furthermore, facts which are true when said must be corrected if they have become untrue by the time the contract is entered into.¹⁶⁹

The common law has always recognized the existence of contracts *uberrimae fidei*, to which *caveat emptor* does not apply. Insurance contracts provide the outstanding example. Here “in

¹⁶⁵ See, *e.g.*, *Stewart v. Wyoming Cattle Rancho Co.*, 128 U.S. 383, 388 (1888).

¹⁶⁶ See 2 RESTATEMENT, CONTRACTS § 471, comment *f*, § 472, comment *b* (1932); *Swinton v. Whitinsville Sav. Bank*, 311 Mass. 677, 42 N.E.2d 808, (1942), advancing powerful arguments in favor of *caveat emptor*; *Perin v. Mardine Realty Co.*, 5 App. Div. 2d 685, 168 N.Y.S.2d 647 (1957), *aff'd*, 6 N.Y.2d 920, 190 N.Y.S.2d 995, 161 N.E.2d 210 (1959); *Grenlac Holding Corp. v. Kahn*, 106 N.Y.S.2d 83 (Sup. Ct. 1951).

¹⁶⁷ *Turner v. Harvey*, Jac. 169, 178, 37 Eng. Rep. 814, 818 (Ch. 1821).

¹⁶⁸ *Donovan v. Aeolian Co.*, 270 N.Y. 267, 271, 200 N.E. 815, 816 (1936).

¹⁶⁹ See *Borzillo v. Thompson*, 57 A.2d 195 (D.C. Munic. Ct. App. 1948); *With v. O'Flanagan*, [1936] 1 All E.R. 727 (C.A.); *Peek v. Gurney*, L.R. 6 H.L. 377, 392, 403 (1873); RESTATEMENT, CONTRACTS § 472(1)(a) (1932).

the nature of things" one party, the insured, has "superior knowledge" of the facts material to the other party's, the underwriter's, decision to issue or not to issue a policy, and the underwriter must rely upon the applicant's making full disclosure.¹⁷⁰ The law, therefore, quite early developed a duty of full disclosure, giving concealment in insurance law a broader meaning than in the ordinary law of contracts.¹⁷¹ But the duty to disclose is not limited to insurance contracts. It extends, although in varying degrees of intensity, to other fiduciary and confidential relations.¹⁷²

Finally, and most importantly, the evolution of implied warranties of quality which, as Parsons correctly saw, are incompatible with *caveat emptor* has considerably reduced its domain, at least in sales of personal property. Their development, which replaced and standardized the duty to disclose, became inevitable with the advent of mass production of goods which were no longer there to be seen and traded face to face by neighbors.¹⁷³ Sales law had to make sure that goods bought were of fair merchantable quality, or fit for the buyer's purpose, unless he had not relied on the seller for the determination of quality. As a result of this development *caveat emptor*, a New Jersey court asserts, "is very nearly abolished" so far as personal property is concerned.¹⁷⁴ Indeed, the need for imposing an implied warranty liability is

¹⁷⁰ PATTERSON, *op. cit. supra* note 163, at 445-59; see *Stipich v. Metropolitan Life Ins. Co.*, 277 U.S. 311 (1928); *Carter v. Boehm*, 3 Burr. 1905, 1910, 97 Eng. Rep. 1162, 1164 (K.B. 1766).

¹⁷¹ See PATTERSON & YOUNG, *CASES ON THE LAW OF INSURANCE* 460 (4th ed. 1961). In England nondisclosure of a material fact, even if not fraudulent, is fatal to recovery on the policy. *Horne v. Poland*, [1922] 2 K.B. 364. In this country that strict rule applies only to non-inland marine insurance. *E.g.*, *Penn Mut. Life Ins. Co. v. Mechanics' Sav. Bank & Trust Co.*, 72 Fed. 413 (6th Cir. 1896). And see PATTERSON, *op. cit. supra* note 163, at 449: "Thus the doctrine of concealment, born in eighteenth-century 'reason,' seems about to perish in twentieth-century 'democracy.'"

¹⁷² They are listed in *A. B. C. Packard, Inc. v. General Motors Corp.*, 275 F.2d 63, 69 n.6 (9th Cir. 1960).

¹⁷³ Dunham, *Vendor's Obligation as to Fitness of Land for a Particular Purpose*, 37 MINN. L. REV. 108, 110-11 (1953); Gilmore, *Law, Logic, and Experience*, 3 How. L.J. 26, 31 (1957). The attempts of sellers to disclaim warranties in fine print do not help the seller guilty of *culpa in contrahendo* in not calling the buyer's attention to the disclaimer's existence. See *Henningsen v. Bloomfield Motors, Inc.*, 32 N.J. 358, 390-405, 161 A.2d 69, 87-96 (1960).

¹⁷⁴ *Levy v. C. Young Constr. Co.*, 46 N.J. Super. 293, 296, 134 A.2d 717, 719 (App. Div. 1957), *aff'd on other grounds*, 26 N.J. 330, 139 A.2d 738 (1958). But implied warranties will not protect the seller from the dangers of arm's length bargaining. See, *e.g.*, *Neill v. Shamburg*, 158 Pa. 263, 27 Atl. 992 (1893).

being realized in areas other than the sale of goods;¹⁷⁵ but there are still vitally important transactions outside its domain.

The sale of real estate seems to form a dramatic illustration. Hornbooks and case law often make the flat statement that there are no implied warranties of quality in the sale of real property. *Caveat emptor*, we are told, still rules supreme and frequently no distinction is made between new and old housing.¹⁷⁶ However one might feel about the social desirability of applying *caveat emptor* to the sale of an old house, the seller of a new house, one would expect, should be held to "an implied warranty" that the house was built in an efficient and workmanlike manner, particularly if he is the builder.¹⁷⁷ But a number of courts have been rather reluctant to impose a warranty liability, even on the builder-vendor.¹⁷⁸ To correct the shortcomings of this point of view, some courts, somewhat artificially, have distinguished between the sale of a finished house and one in the process of construction, imposing an implied warranty in the latter case.¹⁷⁹ Other courts have protected the buyer of real estate including the buyer of an old house, by expanding the domain of misrepresentation or by imposing on the seller a duty to disclose to the buyer known material facts which he knows are not within the reach of reasonable and diligent attention.¹⁸⁰ Indeed, courts in general have be-

¹⁷⁵ See Farnsworth, *Implied Warranties of Quality in Non-Sales Cases*, 57 COLUM. L. REV. 653 (1957).

¹⁷⁶ *Fegeas v. Sherrill*, 218 Md. 472, 147 A.2d 223 (1958); 4 WILLISTON § 926 (rev. ed. 1936).

The difficulties in establishing a standard of fitness for ordinary purposes in land cases, emphasized by Dunham, *supra* note 173, at 111, 118, seem to be exaggerated in the light of German sales cases. See 2 STAUBINGER § 459, Ann. 43-45.

¹⁷⁷ Bearman, *Caveat Emptor in Sales of Realty—Recent Assaults Upon the Rule*, 14 VAND. L. REV. 541, 543 n.7 (1961).

¹⁷⁸ *Levy v. C. Young Constr. Co.*, 46 N.J. Super. 293, 134 A.2d 717 (App. Div. 1957) (strong dissent emphasizes need for warranty in interest of fair dealing), *aff'd on other grounds*, 26 N.J. 330, 139 A.2d 738 (1958). A court willing to protect fair dealing can overcome the doctrine that the original contract is merged in the deed with the help of the notion that an implied warranty as to quality survives the deed as a collateral undertaking. Dunham, *supra* note 173, at 123-24.

¹⁷⁹ *E.g.*, *Vanderschrier v. Aaron*, 103 Ohio App. 340, 140 N.E.2d 819 (1957); *Miller v. Canon Hill Estates, Ltd.*, [1931] 2 K.B. 113. Of course, if the defect can be remedied, the remedy of rescission will give the buyer too much protection, and only damages should be granted. Bearman, *supra* note 177, at 563-64.

¹⁸⁰ *E.g.*, *Clauser v. Taylor*, 44 Cal. App. 2d 453, 112 P.2d 661 (Dist. Ct. App. 1941); *Cohen v. Vivian*, 141 Colo. 443, 349 P.2d 366 (1960) (latent soil defect known to vendor, purchasers had inspected premises and had signed agreement that they had bought on inspection rather than on representation); *Obde v. Schlemeyer*, 56 Wash. 2d 449, 353 P.2d 672 (1960); *Yorke v. Taylor*, 332 Mass. 368, 124 N.E.2d 912 (1955) (misrepresentation expanded). For similar expansion of

come increasingly aware of the presupposition underlying *caveat emptor*, stressed in *Laidlaw v. Organ*: To invoke *caveat emptor* the means of intelligence must be available to both parties.¹⁸¹ Finally, since the concepts of fiduciary and confidential relationships are accordion terms, courts have extensive leeway and are able to expand the duty to disclose by creating a confidential relationship *ad hoc*.¹⁸² Thus, although courts have not always made full use of the arsenal of weapons at their disposal, there is a growing tendency to expand the law of implied warranties and to supplement it by strengthening rules against concealment. The law in the language of Dean Prosser "appears to be working toward the ultimate conclusion that full disclosure of all material facts must be made whenever elementary fair conduct demands it."¹⁸³

D. Misrepresentation

It might be thought that misrepresentation as contrasted with fraud is a superfluous category in the civil law due to the treatment of unilateral mistake. But this is not true. The German experience is quite interesting in this respect. The German civil law, to be sure, has no express provision dealing with innocent misrepresentation as contrasted with fraud. The draftsmen of the code probably took the position that the interests of the mistaken party were sufficiently safeguarded by his privilege to rescind and by the provision that the mistaken party is not liable to pay reliance damages to a party who knows or should have known of the mistake. And yet negligent misrepresentation has found recognition in the case law. The negligent causation of a mistake not only deprives the party causing the mistake of his right to claim reliance damages but exposes him in turn to reliance damage claims by the mistaken party.¹⁸⁴

In the common law countries relief for material misrepresentation has been continuously expanded. Initially the common law

the implied warranty of marketable title and the law of negligence, see Keeton, *Rights of Disappointed Purchasers*, 32 TEXAS L. REV. 1, 3 (1953).

¹⁸¹ 15 U.S. (2 Wheat.) 178 (1817). It should not be overlooked that the case was remanded to determine whether an imposition was practiced on the seller by the buyer.

¹⁸² See DAWSON & HARVEY, *CONTRACTS AND CONTRACT REMEDIES* 580-81 (1959).

¹⁸³ PROSSER, *TORTS* 535 (2d ed. 1955). Courts attempting to work out standards of fair conduct will be greatly aided by Dean Keeton's discussion of factors to be considered in determining the extent of the duty to disclose. Keeton, *Fraud, Concealment and Non-Disclosure*, 15 TEXAS L. REV. 31, 34-37 (1936), criticized in A. B. C. Packard, Inc. v. General Motors Corp., 275 F.2d 63, 69 (9th Cir. 1960).

¹⁸⁴ Sept. 26, 1918, 95 R.G.Z. 58, 60.

was quite reluctant to give damages to the victim of misrepresentation in the absence of fraud. Before the Judicature Act of 1873 the victim of an innocent misrepresentation was only protected at law if the misrepresentation had become a term of the contract or was such as to bring about the complete failure of consideration or, finally, was made recklessly and without care.¹⁸⁵ Equity, however, aware of the injustice of allowing a person who has made a misrepresentation to retain the fruits of the bargain, was ready to grant relief by way of rescission or by permitting the victim to plead misrepresentation as a defense in an action for specific performance.¹⁸⁶ With the fusion of law and equity the principles developed in equity were incorporated into the common law system.¹⁸⁷

1. *Derry v. Peek*. — Relief in the form of damages, on the other hand, was slow in developing. *Derry v. Peek*, denying relief for misrepresentation causing only pecuniary loss unless the misrepresentation was fraudulent,¹⁸⁸ created a powerful roadblock to recovery in England. English textbooks inform us that a fundamental difference still remains between fraud and nonfraudulent misrepresentation. In the latter case the victim is entitled only to rescission but not to damages. But, as the textbooks explain, he may receive "indemnification."¹⁸⁹ He is entitled to be put in *status quo ante*, i.e., if relying on the validity of the contract he has assumed burdens, he is entitled to receive monetary compensation for "obligations discharged or assumed." To preserve the distinction between damages and indemnity, Lord Justice Fry in *Newbigging v. Adam*¹⁹⁰ adopted the following formula: Plaintiff

¹⁸⁵ CHESHIRE & FIFOOT, *CONTRACTS* 225 (5th ed. 1960).

¹⁸⁶ *Smith v. Richards*, 38 U.S. (13 Pet.) 26 (1839); *Taylor v. Burr Printing Co.*, 26 F.2d 331 (2d Cir.), *cert. denied*, 278 U.S. 641 (1928); 5 WILLISTON § 1500 (rev. ed. 1937). For a description of the development in England, see CHESHIRE & FIFOOT, *op. cit. supra* note 185, at 225-26. This development was facilitated by the wider meaning of equitable fraud as contrasted with fraud necessary to support an action of deceit. 1 STORY, *EQUITY JURISPRUDENCE* §§ 191-95 (1st ed. 1835); ANSON, *CONTRACTS* 211 (21st ed. 1959).

¹⁸⁷ See RESTATEMENT, *CONTRACTS* § 470(1), comment a (1932); RESTATEMENT, *RESTITUTION* § 28(b) (1937). There is a growing tendency to emphasize the offeror's duty of honesty over the offeree's duty of self-protection. See 1 HARPER & JAMES, *TORTS*, 551-63 (1956).

¹⁸⁸ [1889] 14 A.C. 337. For an interpretation of *Derry v. Peek*, see *Nocton v. Ashburton*, [1914] A.C. 932, 946.

¹⁸⁹ ANSON, *op. cit. supra* note 186, at 205-06.

¹⁹⁰ 34 Ch. D. 582, 589 (1886), *aff'd*, 13 App. Cas. 308, 331 (1888). The House of Lords, on review, found it unnecessary to decide whether plaintiff was entitled to indemnity for all outstanding debts of the partnership since the only debts were claimed by defendant, whom plaintiff need not pay.

is entitled to an indemnity in respect of all obligations entered into under the contract when those obligations are within the necessary or reasonable expectation of both the contracting parties at the time of the contract. With the help of this formula plaintiff, who was induced to enter into a contract of partnership, was held entitled to be indemnified against the liabilities of the partnership. Lord Justice Bowen's formula in the same case was much narrower. The obligations assumed must be created by the contract. This formula seems to have been adopted in a later case which tries to distinguish between "true indemnity" and damages.¹⁹¹ Plaintiff, a poultry breeder, leased from defendant premises which defendant innocently misrepresented as being in sanitary condition. Plaintiff sued for rescission, and also to recover for rent paid, stock lost, loss of profits on sales, and expenses incurred when its manager fell ill as a result of the insanitary conditions. The court, granting rescission, found that plaintiff was to be put in *status quo ante* only to the extent of being reimbursed for "rents, rates and repairs under the covenants in the lease" but not for the losses itemized by plaintiff. Otherwise, said the court, instead of indemnity, damages would in effect be awarded which, since *Derry v. Peek*, are not recoverable in cases of innocent misrepresentation.¹⁹²

The doctrine of *Derry v. Peek* has enjoyed considerable appeal also in this country. But here the reluctance to grant recovery in damages was gradually overcome in many jurisdictions. Negligent misrepresentation causing economic loss has created liability, occasionally going beyond reliance damages, in situations where the misrepresentation amounted to *culpa in contrahendo*, i.e., was made to the plaintiff in the course of his dealings with the defendant.¹⁹³ But, courts have been reluctant to expand liability to cases where the recipient of the erroneous information made "com-

¹⁹¹ *Whittington v. Seale-Hayne*, 82 L.T.R. (n.s.) 49, 51 (Ch. 1900).

¹⁹² Law Reform Committee, *Tenth Report*, CMD. No. 1782, at 13 (1962), mentions the "narrow and ill-defined distinction drawn in such cases as [*Newbigging* and *Whittington*]" and states that there will be "little room" for this distinction if its recommendation that courts be authorized to award damages instead of or (in cases where the defendant has been at fault) in addition to rescission be adopted.

Use of Fuller's analysis of damages "in terms of the interest protected instead of in terms of the form of the remedy" would obviate the need for such tenuous distinctions. Fuller & Perdue, *The Reliance Interest in Contract Damages* (pts. 1, 2), 46 *YALE L.J.* 52, 373, at 53-57, 409 n.203 (1936, 1937).

¹⁹³ See, e.g., *Mullen v. Eastern Trust*, 108 Me. 498, 81 Atl. 948 (1911); Fuller & Perdue, *supra* note 192, at 409-10 (1936).

mercial use of it in dealing with unspecified strangers," even though the misrepresentor knew or should have known that this might happen. The strangers often remain unprotected, as *Ultramares Corp. v. Touche* strikingly illustrates.¹⁹⁴

Even in the case of "honest" (nonnegligent) misrepresentation there is a strong tendency in this country to grant reliance (but not expectation) damages to the victim. The reason often given strongly reminds us of Jhering's *culpa in contrahendo* rationale: a person who makes an unqualified statement that a fact exists implies he knows it to exist and speaks from his own knowledge. Jhering called this behavior *culpa*; American courts to achieve the desired result frequently label it fraud.¹⁹⁵ Most of the pertinent cases involve sales, rental, and exchange transactions but a few decisions have gone beyond these territories.¹⁹⁶

2. *Estoppel in Pais*. — The story of misrepresentation would be incomplete if we did not discuss another substitute for *culpa in contrahendo*: estoppel in pais, equitable as contrasted with promissory estoppel.¹⁹⁷ According to the law of estoppel, "one who has made positive statements of fact to another, in reliance upon which the latter has acted, [is precluded] . . . from denying its truth in any controversy between the two parties." Moreover, in the modern view, estoppel is not predicated on *scienter* or negligence.¹⁹⁸ Estoppel in pais has been used not infrequently to save the validity of a contract. A well-known opinion written by Story maintains that the acknowledgment of the receipt of consideration cannot be contradicted by showing that consideration was not received.¹⁹⁹ Although this application of the doctrine has met strong criticism it has been repeatedly used against insurance companies. They cannot deny the validity of a policy for nonpayment of a premium if receipt of the premium is acknowledged in

¹⁹⁴ 255 N.Y. 170, 174 N.E. 441 (1931). See generally PROSSER, *op. cit. supra* note 183, at 544. An expansion of protection to include "the class of persons for whose guidance the information was supplied," RESTATEMENT, TORTS § 552(b) (1938), seems, however, to find increasing favor. *E.g.*, *Texas Tunneling Co. v. City of Chattanooga*, 204 F. Supp. 821 (E.D. Tenn. 1962).

¹⁹⁵ See *Stein v. Treger*, 182 F.2d 696 (D.C. Cir. 1950); *New England Foundation Co. v. Elliot A. Watrous, Inc.*, 306 Mass. 177, 27 N.E.2d 756 (1940).

¹⁹⁶ See, *e.g.*, *Baker v. Moody*, 219 F.2d 368 (5th Cir. 1955); *Fidelity & Cas. Co. v. J. D. Pittman Tractor Co.*, 244 Ala. 354, 13 So. 2d 669 (1943) (insurance policy).

¹⁹⁷ For promissory estoppel, see pp. 415, 420, 424 *supra*.

¹⁹⁸ 5 WILLISTON § 1508, at 4205, 4208 (rev. ed. 1937).

¹⁹⁹ *Lawrence v. McCalmont*, 43 U.S. (2 How.) 426, 452 (1844). See criticism of the doctrine in 1 WILLISTON § 115B (3d ed. 1957).

the policy.²⁰⁰ Similarly, a surety is estopped to deny the truths of recitals contained in a document signed by him.²⁰¹

Insurance law is full of illustrations showing the attempts of courts to adjust with the help of estoppel the insurance policy, which is a standardized mass contract, to the needs of the individual policyholder. Insurance companies have been ready to amend the policy by riders and endorsements. But they have attempted to protect themselves against the risks inherent in the agency system of distribution by curtailing the authority of the agent through nonwaiver provisions, stipulating that waivers to be binding must be by the proper authority in compliance with the terms of the policy. The courts, in order to do justice to the insured, taking into account the psychological atmosphere under which insurance is sold, have frequently corrected nonwaiver provisions by estoppel based on the agent's oral misrepresentation or his knowledge of the true facts.²⁰²

IV. CONCLUSION

Our survey shows that notions of good faith and *culpa in contrahendo* have not been confined to civil law countries. As our analysis of compulsory contracts, preliminary negotiations, mistake, and misrepresentation demonstrates, the classical ideas of freedom of contract and arm's length dealings are constantly being challenged and modified in response to the demands of good faith and fair dealing. Although the cases do not use the term *culpa in contrahendo*, its underlying philosophy of responsibility for "blameworthy" conduct has found expression in numerous ways. The increased duty to disclose, the concept of estoppel, the notion of an implied subsidiary promise, the colorful doctrine of "instinct with an obligation," all impose such responsibility. The objective theory of contracts has not obviated the need for some notion such

²⁰⁰ *Farnum v. Phoenix Ins. Co.*, 83 Cal. 246, 23 Pac. 869 (1890); *Basch v. Humboldt Mut. Fire & Marine Ins. Co.*, 35 N.J.L. 429 (Sup. Ct. 1872).

²⁰¹ *McNerney v. Downs*, 92 Conn. 139, 101 Atl. 494 (1917); *State v. United States Fid. & Guar. Co.*, 81 Kan. 660, 106 Pac. 1040 (1910); *Danann Realty Corp. v. Harris*, 5 N.Y.2d 317, 157 N.E.2d 597, 184 N.Y.S.2d 599 (1959) (estoppel used to honor merger clause).

²⁰² For an admirable discussion of the rationale supporting the leading case of *Welch v. Fire Ass'n*, 120 Wis. 456, 98 N.W. 227 (1904), see PATTERSON & YOUNG, *op. cit. supra* note 171, at 556-58. But see *John Hancock Mut. Life Ins. Co. v. Luzio*, 123 Ohio St. 616, 176 N.E. 446 (1931) (no protection: collusion between agent and applicant). See generally Morris, *Waiver and Estoppel in Insurance Policy Litigation*, 105 U. PA. L. REV. 925 (1957).

as *culpa in contrahendo*, for it has sometimes proved too weak to protect legitimate expectations of fair dealing, while at other times it has been too harsh in its failure to provide relief from mistake. The ideal of security of transactions, a corollary of the objective theory of contracts, has had to make room for flexibility. In the language of Corbin, "certainty in the law is largely an illusion at best, and altogether too high a price may be paid in the effort to attain it."²⁰³ Indeed, we may argue that a more satisfactory degree of "certainty" is attained with flexible notions of fairness eliminating the need to circumvent the inflexible application of mechanical rules.

Of course, there are real dangers in any overenthusiastic and indiscriminate embracing of good faith notions. Judicial intervention in the name of fairness must find its limit when it impinges too greatly on private autonomy. And a deterioration of the law of contract into "well-meaning sloppiness of thought" must be avoided so as not to disregard the fundamental moral principle of responsibility for one's own action. Nevertheless, good faith and *culpa in contrahendo*, used with restraint, are "residual" categories²⁰⁴ whose existence is vital to an open system of contract justice and to a restriction of contractual freedom in the interest of its own preservation. The law confronts the task, in the interest of certainty, of identifying and categorizing these amorphous "residual" concepts, only to be faced with the realization that this process is never-ending.

²⁰³ 3 CORBIN § 609, at 689 (rev. ed. 1960).

²⁰⁴ PARSONS, *THE STRUCTURE OF SOCIAL ACTION* 16-27 (1949).